The Mergers & Acquisitions Review

Ninth Edition

Editor
Mark Zerdin

Law Business Research

The Mergers & Acquisitions Review

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EDITOR'S PREFACE

By a number of measures, it could be argued that it has been some time since the outlook for the M&A market looked healthier. The past year has seen a boom in deal making, with many markets seeing post-crisis peaks and some recording all-time highs. Looking behind the headline figures, however, a number of factors suggest deal making may not continue to grow as rapidly as it has done recently.

One key driver affecting global figures is the widely expected rise of US interest rates. Cheap debt has played a significant part in the surge of US deal making in the first few months of 2015, and the prospects of a rate rise may have some dampening effects. However, the most recent indications from the Federal Reserve have suggested that any rise will be gradual and some market participants have pushed back predictions for the first rate rise to December 2015. Meanwhile, eurozone and UK interest rates look likely to remain low for some time further.

The eurozone returned to the headlines in June as the prospect of a Greek exit looked increasingly real. Even assuming Greece remains in the euro (as now seems likely), the crisis has severely damaged the relationship between Greece and its creditors. The brinksmanship exhibited by all parties means that meaningful progress cannot occur except at the conclusion of a crisis: the idea that reform will benefit Greece has been lost and each measure extracted by creditors is couched as a concession. However, while the political debate has become ever more fractious, the market's response to the crisis has been relatively sanguine. This is largely a result of the fact that the volume of Greek debt is no longer in the market, but in the hands of institutions. But it is also a sign of the general market recovery and expectations that major economies will continue to grow.

Perhaps one of the more interesting emerging trends in the last year is the interplay between growth and productivity. Some commentators have suggested that the recent rise in deal making is a symptom of a climate in which businesses remain reluctant to invest in capital and productivity. Pessimistic about the opportunities for organic growth, companies instead seek to grow profits through cost savings on mergers. It is difficult to generalise about such matters: inevitably, deal drivers will vary from industry to industry, from market to market. However, if synergies have been the principal motivation in

much of the year's deal making (it certainly has been in a number of large-cap deals) then it may be that the market is a little farther from sustainable growth than some would like to think.

I would like to thank the contributors for their support in producing the ninth edition of *The Mergers & Acquisitions Review*. I hope that the commentary in the following chapters will provide a richer understanding of the shape of the global markets, together with the challenges and opportunities facing market participants.

Mark Zerdin
Slaughter and May
London
August 2015

Chapter 66

UNITED STATES

Richard Hall and Mark Greene[1]

I OVERVIEW OF M&A ACTIVITY

Calendar year 2014 saw a substantial increase in merger and acquisition (M&A) activity globally and in the United States. Total 2014 US M&A activity[2] by dollar volume increased by 50.2 per cent over 2013 levels, benefiting from global and national economic recovery, high stock prices and low interest rates.[3] The value of US domestic deals[4] increased 158.5 per cent over 2013 levels, making 2014 the most active year for domestic deals since 2007.[5] US outbound M&A reached the highest value and deal count on record and was up 65.9 per cent from 2013 levels, with tax inversions strongly contributing to this increase.[6] Announced US targeted M&A[7] reached $2.1 trillion in

1 Richard Hall and Mark Greene are corporate partners at Cravath, Swaine & Moore LLP. The authors would like to acknowledge the contributions of fellow partners Eric Hilfers, Len Teti and Christine Varney and associates Rebecca Hurt, Jesse Weiss, Karice Rhule and Kristin Rulison.

2 US M&A activity includes announced deals where the target or acquirer is domiciled in the US.

3 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, Thomson Reuters (2014), http://online.thomsonone.com.

4 Domestic deals are those where the US is the dominant geography of the target and bidder.

5 'Global and Regional M&A: 2014', Mergermarket, January 2015, www.mergermarket.com/pdf/Mergermarket%202014%20M &A%20Trend%20Report.%20Financial%20Advisor%20League%20Tables.pdf.

6 Id.

7 US targeted M&A includes announced deals where the target is a US entity (whether a standalone entity or division).

dollar volume, up 51.4 per cent from 2013.[8] This rise in US M&A activity follows the worldwide current: global M&A activity had its strongest annual period since the financial crisis, with overall value up 47 per cent from 2013 levels, fuelled by over 40,400 deals announced worldwide.[9]

The upswing in US M&A activity resulted from a spike in mega-deals rather than in absolute deal volume and predominantly occurred in the public M&A sector. The 50.2 per cent increase in US M&A by dollar volume was accompanied by a deal count increase of only 10 per cent over 2013 levels.[10] Within US public M&A, the number of deals over $100 million only increased 7.9 per cent from 2013, but the average value of those announced deals more than tripled, going from $1.3 billion to over $4.5 billion, and the average value of the 10 largest US public mergers rose from $6.4 billion to $44.4 billion.[11] The number of acquisitions of US public companies valued at $5 billion or above more than doubled from 2013, and these deals represented close to a quarter of overall US M&A activity, up from 10 per cent the previous year.[12] These large cap public deals were at the core of US M&A in 2014, representing some of the largest financings and the most notable hostile deals and being at the centre of some of the regulatory issues which arose in 2014.

This rise in US public M&A was dominated by strategic, rather than financial, acquirers, as financial acquirer transactions dropped from around 25 per cent in 2013 to 12.6 per cent.[13] One factor that contributed to the rise of strategic acquirers was the rise in stock prices as acquirers used their own highly valued stock to buy competitors. In 2014, nearly 50 per cent of public deals included stock as part or all of the consideration, as opposed to only 30 per cent the previous year.[14] Of the top 15 worldwide mega-deals, the eight that had both a US acquirer and a US target involved stock as part of the consideration.[15] Leveraged public US M&A only slightly rose in 2014, going from 40.7 per cent in 2013 to 47 per cent.[16]

The mega-deals that caused the US M&A surge are a worldwide phenomenon but particularly prevalent in the US. Of 95 worldwide deals over $5 billion, the top five were each over $50 billion and involved a US acquirer and a US target, and, of the top

8 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, *supra* note 3; Mergers & Acquisitions Review, Full Year 2013, Financial Advisors, Thomson Reuters (2014), http://online.thomsonone.com.

9 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, *supra* note 3.

10 Id.

11 Practical Law Company, 'What's Market: 2014 Public M&A Wrap-up', 28 January 2015, http://us.practicallaw.com/3-597-1086?q=What's+Market:+2014+Year-end+Public+M%26A+Wrap-up; '2014 Year-End Roundup', Paul, Weiss, Rifkind, Wharton & Garrison, 15 January 2015, www.paulweiss.com/media/2765032/ma_2014_year-end_roundup.pdf.

12 Id.

13 Id.

14 Id.

15 Id.

16 Id.

15 (ranging from $17.1 to $70.7 billion in deal value), eight involved both a US acquirer and a US target and two more involved at least one US party.[17] Within US mega-deals, five of the top-10 US deals were in the media and entertainment, and pharmaceutical and health-care sectors, which is consistent with the worldwide M&A trend in which media and entertainment M&A activity doubled and health-care M&A activity rose 94 per cent from the previous year.[18]

The continued viability of some of these mega-deals is being called into question by regulatory concerns. Topping the list of US targeted M&A in 2014 were two media and entertainment or cable mega-deals, which have since been stalled or entirely blocked by regulatory review. The first was the announced acquisition of Time Warner Cable Inc by Comcast Corp, with a deal value of $70.7 billion, which was abandoned in late April 2015 under pressure from antitrust regulators.[19] The second was the announced acquisition of DirectTV Inc by AT&T Inc with a deal value of $67.2 billion, which is under Federal Communications Commission (FCC) review. The deal was stalled in March 2015 as the FCC paused its 180-day review of the proposed merger, waiting for the DC Circuit Court of Appeals to rule on contract information disclosure to third parties.[20] The court ruled for the broadcasters and FCC review picked up again in May 2015, with the outcome still undecided.[21] That said, US-targeted M&A continued to strengthen in the first quarter of 2015, totalling $415.9 billion, up 33 per cent by dollar volume from the first quarter of 2014 and reaching the highest first quarter level since 2000, with US mega-deals still strongly represented (including the HJ Heinz Co acquisition of Kraft Foods Group Inc for $54.7 billion).[22]

Along with mega-deals, inversions and shareholder activism played important roles in structuring US public M&A in 2014, though the rising use of inversions slowed in late 2014 due to government regulation.[23]

17 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, *supra* note 3.

18 Id.

19 Id.; Shalini Ramachandran, 'Comcast Kills Time Warner Cable Deal', *Wall Street Journal*, 24 April 2015, www.wsj.com/articles/comcast-kills-time-warner-cable-deal-1429878881.

20 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, *supra* note 3; Thomas Gryta and Shalini Ramachandran, 'FCC Puts Review of Comcast-Time Warner, AT&T-Direct TV Deals on Hold', *Wall Street Journal*, 13 April 2015, www.wsj.com/articles/fcc-puts-review-of-comcast-time-warner-at-t-directv-deals-on-hold-1426276188.

21 Meg James, 'Court Backs Broadcasters, Clears Way for FCC Review of AT&T-DirectTV Merger', *LA Times*, 8 May 2015, www.latimes.com/entertainment/envelope/cotown/la-et-ct-broadcasters-fcc-dispute-att-directv-merger-review-20150508-story.html.

22 Mergers & Acquisitions Review, First Quarter 2015, Financial Advisors, Thomson Reuters (2015), http://online.thomsonone.com.

23 'What's Market: 2014 Public M&A Wrap-up', *supra* note 11.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

M&A in the US is governed by a dual regulatory regime, consisting of state corporation laws (e.g., the Delaware General Corporation Law (DGCL)) and the federal securities laws (primarily, the Securities Act of 1933 and the Securities Exchange Act of 1934). The Securities and Exchange Commission is the regulatory agency responsible for administering the federal securities laws. The federal securities laws apply in the context of a merger, including proxy rules that govern the solicitation of the approval of a target company's shareholders. The federal securities laws relating to tender offers apply in the context of an offer to purchase shares of a publicly held target company. In addition to these laws, an acquisition or merger will imply fiduciary duties, as developed and applied in the state of incorporation of the target company.

Unlike most other jurisdictions, the US patchwork of federal and state regulation of acquisitions is not focused on the substantive issue of regulating changes of control of target companies. Rather, US federal regulation focuses on disclosure, ensuring that common shareholders of target corporations are given the time and information required to make a fully informed decision regarding the acceptance of a tender offer or vote in favour of a merger.

Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the HSR Act), an acquirer is normally required to make a filing with US antitrust authorities prior to completing the acquisition. Generally, the HSR Act requires notification if the size of the transaction exceeds $76.3 million (adjusted annually for inflation); the requirement was increased from $75.9 million in 2014.[24]

There is no general statutory review process governing foreign investment in the United States. Under the Exon-Florio Amendment to the Defence Production Act of 1950 (Exon-Florio Amendment), however, the President, through the Committee on Foreign Investment in the US (CFIUS), has the power to review, investigate, prohibit or unwind transactions involving investments by non-US entities that threaten to impair national security.[25] The 1992 Byrd Amendment also requires CFIUS to conduct a full Exon-Florio investigation whenever CFIUS receives notice of a foreign government-led takeover of a US business that may affect national security.[26]

There are also additional industry-specific statutes that may require advance notification of an acquisition to a governmental authority. Examples of regulated industries include airlines, broadcasters and electric and gas utilities.

24 'FTC Announces New Thresholds for Clayton Act Antitrust Reviews for 2015', Fed. Trade Comm'n, www.ftc.gov/news-events/press-releases/2015/01/ftc-announces-new-thresholds-clayton-act-antitrust-reviews-2015.

25 50 U.S.C. app, Section 2170.

26 Pub. L. No. 102-484 (1992).

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Standard of review for certain controlling shareholder transactions

In *In re MFW Shareholders Litigation*, the Delaware Court of Chancery issued a seminal opinion establishing that the deferential business judgement rule is the appropriate standard of review in the case of a merger between a controlling shareholder and its subsidiary where from the outset the controlling shareholder agrees the transaction will be conditioned on the approval of both an independent and empowered (to negotiate and not simply evaluate) special committee that fulfils its duty of care and the uncoerced and informed vote of a majority of the minority of shareholders unaffiliated with the controlling shareholder.[27]

Prior to *In re MFW*, where a controlling shareholder stood on both sides of a transaction, the actions of the target's board of directors were reviewed under the exacting entire fairness standard as the transaction was necessarily a conflicted one. Under entire fairness, the Delaware courts evaluate the entirety of the transaction focusing on two interrelated prongs: whether a fair process was used and whether a fair price was paid.[28] The best defendants could hope for was shifting the burden to plaintiffs by conditioning the transaction on either a special committee of independent directors or the approval of the majority of the minority of shareholders unaffiliated with the controlling shareholder.[29] The Delaware courts had never had occasion to opine on the appropriate standard of review if both protections were in place.

In *In re MFW*, the defendants argued that the use of both protections created an arm's-length dynamic that called for review under the business judgement rule, under which a Delaware court will not second-guess a board of directors' decision if it can be attributed to any rational purpose.[30] The Court of Chancery largely agreed with this reasoning and noted that, because controlling shareholders did not receive 'extra legal credit' for putting in place both legal protections (i.e., burden shifting remained the best possible outcome), there had been no incentive for them to do so.[31] Acknowledging that its decision could be overturned by the legislature or the Delaware Supreme Court, the Court of Chancery, after reviewing the independence of the special committee and whether or not it had been sufficiently empowered and had fulfilled its duty of care, adopted the business judgement rule as the appropriate standard of review.[32]

In March 2014, the Delaware Supreme Court upheld the Court of Chancery's decision, but modified the Court of Chancery's duty of care test.[33] The Supreme Court

27 *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013).

28 *In re S. Peru Copper Corp. S'holder Derivative Litig.*, 52 A.3d 761, 787, 2011 Del. Ch. LEXIS 212, 75 (Del. Ch. 2011) (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

29 *In re MFW S'holders Litig.*, 67 A.3d at 500 (quoting *Kahn v. Lynch Commun. Sys.*, 638 A.2d 1110, 1117 (Del. 1994)).

30 *In re MFW S'holders Litig.*, 67 A.3d at 500.

31 Id. at 500-01.

32 *In re MFW S'holders Litig.*, 67 A.3d at 501-04.

33 *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

held that in particular the duty of care has to be met with respect to negotiating price.[34] In a footnote, the Supreme Court noted various claims in the class complaint regarding price (e.g., the final merger price was $2.00 lower than the company's trading price two months earlier) that could have called into question the sufficiency of the special committee's negotiations, requiring discovery to determine whether the test had been satisfied.[35] The Supreme Court's discussion regarding whether the special committee adequately conducted negotiations, in effect, blurred the lines between application of the business judgement rule and entire fairness. The type of allegations that the Supreme Court pointed to are common in complaints regarding controlling shareholder transactions. The Supreme Court's focus on due care with respect to price could limit the benefits of the standard as established by the Court of Chancery necessitating extensive discovery and leaving a target board of directors in the context of a takeover by controlling shareholder, unsure as to whether the business judgement rule will ever apply to its actions.

In August 2014, the Delaware Court of Chancery attempted to remove some of this uncertainty by shifting the burden of proof to the plaintiffs, requiring them to plead sufficient facts to demonstrate that the elements of the duty of care test had not been meet and that application of the business judgment rule was therefore unwarranted.[36] While the court's stance fails to guarantee to a target board of directors that the business judgment rule will be applied to its action, it could allow defendants to dismiss cases at the pleading stage, by limiting plaintiffs' ability to get to discovery by relying on mere allegations of the board of director's failure. The decision also clarified that the negotiating price would only be reviewed under a gross negligence test (the standard a board of directors is held to) at the pleading stage, doing away with concerns of an entire fairness review before trial. The decision is a bench ruling, and therefore not technically precedential, but it is the first decision following the March 2014 decision and potentially reveals a permanent clarification in the test's application.

ii Facilitation of the two-step merger

In August 2013, Section 251(h) of the DGCL was added to Section 251, eliminating the requirement for a shareholder vote in certain two-step mergers. In August of 2014, Section 251(h) was amended to allow application of the provision even when an 'interested stockholder' is involved and to remove Section 251(h)'s mandatory application, now allowing, rather than requiring, parties to a merger agreement to rely on it and expanding their world of regulatory options to consummate the transaction.

A two-step merger is a hybrid acquisition structure for a target company that combines a tender or exchange offer (offer) with a 'back-end' merger, in which shareholder approval is a fait accompli, or a short-form merger, in which shareholder approval is not required by law. This is in contrast to a one-step long-form merger in which the shareholders of the target company generally have a meaningful vote on the

34 M&F Worldwide Corp., 88 A.3d at 644-45.

35 M&F Worldwide Corp., 88 A.3d at 645, n.14.

36 *Swomley v. Schlecht*, No. 9355-VCL (Del. Ch. Aug. 27, 2014) (Transcript).

transaction. The advantage of the two-step merger, in particular where the consideration is cash and regulatory review is not required, is speed. An all-cash two-step merger can be accomplished in a matter of weeks whereas a one-step merger can take several months.

In the case of a two-step merger, the first-step offer is generally conditioned on the tender of the minimum number of shares required to give the acquirer sufficient voting power to approve the second-step merger. If the acquirer holds at least 90 per cent of the target company's common stock after the offer, the acquirer is able to quickly (e.g., the same day) effect a short-form merger under Section 253 of the DGCL, for which a shareholder vote is not required. Often a two-step merger agreement will include a 'top-up' option, which provides that the target company will issue the remaining shares of common stock necessary to put the acquirer at the 90 per cent mark. However, prior to Section 251(h), if for whatever reason the top-up option was not available (e.g., the target company did not have sufficient authorised and unissued shares), the acquirer had to go through the process of obtaining a shareholder vote, even if the vote was a mere formality because the acquirer had obtained the requisite voting control through the offer. Having to obtain the shareholder vote could prove costly to the acquirer, both in terms of the expense of preparing the proxy materials and with respect to the cost of, and access to, debt financing. In addition to any financing needed to acquire the target company's shares, the closing of the offer would also likely require refinancing of the target company's debt. For a corporation with a robust balance sheet, this may not have proved to be a problem, but it placed financial acquirers at a disadvantage. Prior to the consummation of the back-end merger, the acquirer would not have access to the target company's assets for purposes of collateral and the acquirer's ability to borrow funds using the shares as security is limited by US margin rules (no more than 50 per cent of the purchase price of the shares can be borrowed).

When enacted, Section 251(h) bridged the gap between the long-form merger approval threshold and the 90 per cent short-form merger threshold. Subject to certain conditions, it provided that in the case of a two-step merger, if following the consummation of the offer, the acquirer holds the requisite number of shares to approve the back-end merger, shareholder approval is not required. In addition to getting deal proceeds into the hands of shareholders as quickly as possible, the provision provided the added benefit of levelling the playing field for acquirers obtaining third-party financing, potentially increasing the potential number of competitive bids.

In August 2014, Section 251(h) was amended to remove the 'interested stockholder' restriction; it allows the provision to be used even if a party to the merger agreement at the time the agreement receives board approval is an 'interested stockholder' as defined in Section 203 of the DGCL (generally a holder of 15 per cent more of the target company's outstanding shares), which was previously prohibited. This expansion permits acquirers to enter into tender and support agreements with shareholders or groups of shareholders that own 15 per cent of the target company's stock, permitting management buyouts and also allowing acquirers to rely on both Section 251(h) and the assurance of locking up a significant portion of a target company's shares, opening the door for Section 251(h) to be used in the context of 'going private' transactions. In the 12-month period following the adoption of Section 251(h), two-step mergers were used in 34 per cent of all M&A transactions with a Delaware corporate target, as opposed to only 23 per cent in the year

leading up to it.[37] Of the two-step mergers that did not rely on Section 251(h) during that time period, 49 per cent involved tender or support agreement, which suggest we can expect a further surge in two-step mergers now that the 'interested stockholder' restriction has been lifted.[38] That said, the removal of the restriction in Section 251(h) has not removed the restrictions on 'interested stockholder' transactions in Section 203 and the exact amount of the increase is still to be determined.[39]

The amendment makes further changes to Section 251(h). It makes the provision 'opt-in' rather than exclusive, permitting parties to a merger agreement to rely on the provision if they explicitly elect it, but allowing them to abandon it in favour of consuming the transaction under another statutory provision they find more beneficial. This gives parties to a merger agreement greater comfort as they enter into the merger process; they can rely on the section but can save the merger with another provision if Section 251(h) is revealed unusable. The amendment also clarifies that an offer for 'any and all of the outstanding stock' of a target may exclude stock owned by the target, the acquirer and some of their affiliates, making the 90 per cent ownership threshold easier to attain, but it also now requires that the shares (of the acquirer, the target or a tendering stockholder) be actually received by the depositary to be counted towards the ownership threshold.

iii Forum by-laws

From 2010 until 2013, 90 per cent or more of US M&A deals over $100 million resulted in shareholder litigation, with 62 per cent of deal litigation being multi-jurisdictional and deals facing an average of five lawsuits.[40] Plaintiffs engaging in forum shopping (the practice of filing claims in the jurisdiction(s) most likely to be favourable to their claim) tend to file claims in multiple jurisdictions. Other plaintiffs simply file in their own jurisdiction for convenience, failing to group their claims with those of other shareholders, resulting in corporations having to litigate similar claims in multiple jurisdictions, with all associated burdens: inconsistent results across claims, increased costs due to multiple counsels, filings and proceedings, and litigating claims in courts with less expertise on certain corporate matters pertinent to the corporations concerned.[41] In response, corporations began enacting unilateral by-law amendments to implement forum by-laws – provisions in their charters or by-laws that provide for an exclusive forum (generally their state of incorporation) in which their shareholders could bring suit against them. In

37 'Section 251(h) Year in Review', Morris Nichols Arsht & Tunnell, www.mnat.com/assets/htmldocuments/Section215h_MorrisNicholsReport_Sept2014.pdf.

38 Id.

39 Id.

40 'Shareholder Litigation Involving Mergers and Acquisitions—Review of 2013 Litigation', Cornerstone Research, February 2014, www.cornerstone.com/GetAttachment/73882c85-ea7b-4b3c-a75f-40830eab34b6/-Shareholder-Litigation-Involving-M-and-A-2013-Filings.pdf.

41 'Exclusive Forum By-laws Gain Momentum', 28 May 2014, Sullivan & Cromwell LLP, www.sullcrom.com/siteFiles/Publications/SC_Publication_Exclusive_Forum_By-laws_Gain_Momentum.pdf.

2013, the Delaware Chancery Court held that forum selection clauses in a corporation's by-laws were facially valid under the DGCL and hundreds of Delaware corporations subsequently announced or adopted forum by-laws.[42]

In 2014, in *City of Providence v. First Citizens BancShares, Inc*, the Delaware Chancery Court reaffirmed its support of forum by-laws and granted more flexibility as to the chosen and the timing of the by-laws' adoption.[43] *First Citizens* upheld a corporation's selection of its principal place of business as its exclusive forum, which in this case was North Carolina.[44] This was notable not only because it was not the corporation's state of incorporation but also because a Delaware court upheld a non-Delaware forum as exclusive in ruling over matters of Delaware corporate law. First Citizens also upheld the board of director's adoption of the forum by-laws on an 'allegedly cloudy day' (simultaneously with a transaction which is now alleged to be a wrongdoing) rather than on a 'clear day' (in the absence of a simultaneous transaction).[45] The court found the distinction 'immaterial given the lack of any well-pled allegations... demonstrating any impropriety in this timing,' making it clear that the timing itself – which was simultaneous with the board action under review (in this case, execution of a merger agreement) – does not in itself render adoption of the forum by-laws improper.[46]

Forum by-laws are not exclusive to Delaware and courts in several states have dismissed shareholder litigation on the basis of forum by-laws.[47] Though one court in California has, post-*First Citizens*, invalidated a forum by-law due to 'the closeness of the timing to the by-law amendment to the board's alleged wrongdoing', another upheld a similar forum by-law despite it being enacted when a merger agreement was signed, suggesting the Delaware trend may spread.[48] Legislation was adopted in Delaware in June 2015, which formally authorises certificates of incorporation or by-laws to include 'forum by-laws'. While the legislation neither expressly authorises nor expressly prohibits selecting a forum other than Delaware, it does invalidate 'forum by-laws' that select another forum to the exclusion of Delaware.[49]

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42 *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013); see Claudia H. Allen, 'Trends in Exclusive Forum By-laws: They're Valid, Now What?', 18 November 2013, Katten Muchin Rosenman LLP.

43 *City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229 (Del. Ch. 2014).

44 Id. at 240.

45 Id. at 241.

46 Id.

47 'Exclusive Forum By-laws Gain Momentum', *supra* note 41.

48 *Roberts v. TriQuint Semiconductor, Inc.*, No. 1402-02441, slip op. at 9-10 (Or. Cir. Ct. Aug. 14, 2014); *Brewerton v. Oplink Communications Inc.*, No. RG14-750111 (Super. Ct. Cal. Dec. 12, 2014).

49 A copy of the proposed amendments is available at: http://legis.delaware.gov/LIS/lis148.nsf/vwLegislation/SB+75/$file/legis.html?open.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

i Inversions

The phenomenon of US corporations reincorporating in low-tax jurisdictions, inversions, is not new. US tax rates are some of the highest globally and US-based companies consistently look for ways to shield their international earnings from those rates. In the past, a company was able to simply reincorporate in a foreign jurisdiction or move to a country in which it was already doing a substantial amount of business and benefit from the country's lower tax rate.[50] For this to work, 25 per cent of the company's sales, assets and employees had to be domiciled in the new jurisdiction.[51] This is a difficult burden for most companies to meet and in the past few years, most inversions were achieved through multibillion-dollar cross-border M&A, 'acquisition inversions'.[52] Under the rules governing acquisition inversions, a foreign target company and acquirer can be combined under a new holding company formed under the laws of a lower-tax foreign jurisdiction, whether or not it is the target company's jurisdiction of organisation, if less than 80 per cent of the combined entity's stock is owned by the former shareholders of the US company.[53] While the past three years have seen a rise in inversions, more notable is the fact that inversions represented 6 per cent of worldwide M&A activity in 2014 due to a wave of high-profile, large-dollar-value inversions, and by September, 2014 had already seen approximately 55 per cent of all inversion dollar value since 1996.[54]

In February 2014, Endo International PLC (formerly Health Solutions Inc) completed its acquisition of Canadian company Paladin Labs Inc for $1.6 billion and reincorporated in Ireland in March 2014, a move expected to save it millions of dollars in taxes.[55] In March 2014, Horizon Pharma Inc agreed to acquire Vidara Therapeutics Inc for $600 million, forming a new combined company organised in Ireland that

50 David Gelles, 'New Corporate Tax Shelter: A Merger Abroad', New York Times, 8 October 2013, http://dealbook.nytimes.com/2013/10/08/to-cut-corporate-taxes-a-merger-abroad-and-a-new-home/.

51 David Gelles, 'Obama Budget Seeks to Eliminate Inversions', New York Times, 5 March 2014, http://dealbook.nytimes.com/2014/03/05/obama-budget-seeks-to-eliminate-inversions/.

52 Id.

53 Press Release, Dep't of the Treasury, 'Fact Sheet: Treasury Actions to Rein in Corporate Tax Inversions', 22 September 2014, http://www.treasury.gov/press-center/press-releases/Pages/jl2645.aspx.

54 See Gelles, 'Obama Budget Seeks to Eliminate Inversions', *supra* note 51; Janet Novack and Liyan Chen, 'The Tax Inversion Rush – In One Handy Graphic', Forbes, September 10, 2014, http://www.forbes.com/sites/janetnovack/2014/09/10/the-tax-inversion-rush-in-one-handy-graphic/.

55 John George, 'Endo Re-Incorporates in Ireland to Save Millions in Taxes', Philadelphia Business Journal, 11 March 2014, http://www.bizjournals.com/philadelphia/blog/health-care/2014/03/why-endo-re-incorporated-in-ireland.html.

is expected to lower the combined company's tax rate to the low 20 per cent range.[56] In April and May 2014, Pfizer Inc made offers reaching $119 billion for the United Kingdom-based AstraZeneca PLC, making the tax benefit a clear part of their proposal to AstraZeneca, though eventually getting rejected.[57] In July 2014, Italian drug maker Cosmo Technologies Ltd and Salix Pharmaceuticals Ltd announced a $2.7 billion inversion, and AbbVie Inc and British company Shire PLC announced an inversion valued at $54.8 billion, both of which were ultimately terminated for regulatory reasons described below. That same month, Mylan Inc and Abbott Laboratories announced a $5 billion transaction pursuant to which Mylan would reincorporate in the Netherlands thereby reducing its tax rate to the 20 per cent range and the high teens going forward. In August 2014, after much speculation about whether it would consummate the merger with an inversion, Walgreens Co announced it would (and it eventually did) complete an inversion-free acquisition of the Switzerland-based Alliance Boots GmbH; its decision came shortly after the US Treasury threatened restrictions on tax benefits to US companies relocating abroad for tax reasons.[58] In September 2014, Burger King Worldwide Inc announced its acquisition of Tim Hortons Inc (which it completed in December 2014) and its reincorporation in Canada. The inversion is expected to allow Burger King to avoid hundreds of millions of dollars in US taxes going forward.[59] Burger King's announcement was promptly followed by a governmental announcement of measures to reduce the benefit of corporate inversions.

Governmental measures against corporate inversions are not new, and attempts to rein in such transactions have continued as the US government sees more and more taxable revenue escaping its reach, but the solutions to date have been ineffectual.[60] In September 2014, the US Department of Treasury and the Internal Revenue Service issued a notice of measures intended to render certain inversion-related tax practices more expensive for US companies and raise the bar for inversion eligibility (see Section VIII of this chapter for further discussion on the proposed regulation).

Though the new regulations' long-term impact is still uncertain, after their announcement the wave of inversions slowed for the remainder of 2014 and a few

56 Vrinda Manocha, 'With Eye on Tax Rates, Horizon Pharma Buys Ireland's Ireland', 19 March 2014, www.reuters.com/article/2014/03/19/us-horizonpharma-acquisition-vidara-idUSBREA2I0PE20140319.

57 Harry Stein, 'Pfizer's Tax-Dodging Bid for AstraZeneca Shows Need to Tighten U.S. Tax Rules', 13 May 2014, Center for American Progress, www.americanprogress.org/issues/regulation/news/2014/05/13/89597/pfizers-tax-dodging-bid-for-astrazeneca-shows-need-to-tighten-u-s-tax-rules/.

58 Jennifer Rankin, 'Tax Inversion Takes a Hit as Walgreens Alliance Boots Stays in US', *The Guardian*, 6 August 2014, www.theguardian.com/business/2014/aug/06/walgreens-buy s-alliance-boots-9bn-pounds.

59 Kevin Drawbaugh, 'Burger King to Save Millions in US Taxes in 'Inversion': study', 11 December 2014, www.reuters.com/article/2014/12/11/us-usa-tax-burgerking-idUSKBN0JP0CI20141211.

60 Gelles, 'New Corporate Tax Shelter', *supra* note 50.

high-profile acquisition-inversion deals were terminated. Blaming the new inversion rules and uncertainty regarding future regulation as the drivers, AbbVie Inc terminated its $54 billion bid for Shire PLC in October 2014, incurring a $1.6 billion termination fee.[61] That same month, Salix Pharmaceuticals Ltd and Cosmo Technologies Ltd terminated a $2.7 billion merger agreement with a $25 million termination fee, also citing regulatory concerns. As the Treasury Department continues its efforts to prevent inversions, a possible risk facing companies is a retrospective regulation that would claw back billions of dollars of tax revenue and potentially unwind completed deals, with unpredictable consequences.

ii CFIUS review

Ralls update

In September 2012, President Obama blocked the first merger on CFIUS-related national security grounds in 22 years. Such authority was given to the President under the Exon-Florio Amendment, which was enacted amid concerns over foreign acquisitions, particularly Japanese firms.[62] The transaction at issue was the acquisition by Ralls Corporation (Ralls), a Delaware company owned by executives of China's largest machinery manufacturer, of four wind farm projects near the Naval Weapons Systems Training Facility in Oregon. Ralls had not notified CFIUS prior to the consummation of the transaction. Challenging the President's order, Ralls filed suit claiming that the order, *inter alia*, was an unconstitutional deprivation of property without due process. Having previously dismissed Ralls' other claims, in October 2013, the US District Court for the District of Columbia dismissed Ralls' due process claim.[63] Part of the Court's analysis focused on the fact that Ralls elected not to notify the CFIUS prior to the closing and therefore acquired the property subject to the known risk of the presidential veto. Ralls appealed and, in July 2014, the US Court of Appeals for the District of Columbia ruled that Ralls had not been afforded due process before being deprived of property.[64] The court granted Ralls the right to review and rebut unclassified information that had been used during the CFIUS review process.[65] In November 2014, Ralls was handed unclassified information and factual findings generated during the review, which were the basis for the CFIUS decision, and the district court set a framework in which

61 David Gelles, 'After Tax Inversion Rules Change, AbbVie and Shire Agree to Terminate Their Deal', *New York Times*, 20 October 2014, http://dealbook.nytimes.com/2014/10/20/abbvie-and-shire-agree-to-terminate-their-deal/.

62 Sara Forden, 'Chinese-Owned Company Sues Obama Over Wind Farm Project', Bloomberg, 2 October 2012, (on file with author); James K. Jackson, 'The Exon-Florio National Security Test for Foreign Investment', Congressional Research Service, 29 March 2013, www.fas.org/sgp/crs/natsec/RL33312.pdf.

63 *Ralls Corp. v. Comm. on Foreign Inv. in the United State*s, CV 12-1513 (ABJ), 2013 WL 5565499, *7 (D.D.C. Oct. 9, 2013), as amended (10 October 2013).

64 *Ralls Corp. v. CFIUS*, 758 F.3d 296, 321 (D.C. Cir. 2014).

65 Id. at 319.

Ralls could contest the information.[66] While the outcome for Ralls of this imparted information is currently unknown, the appellate court's decision could impact the overall CFIUS reviews process. CFIUS, now aware that the underlying information and its findings could be disclosed if its decision is contested, has an incentive to exchange information with parties early, grant them a right to rebuttal and address those rebuttals, in order to avoid an appeal with the courts. This may lengthen the review process but the right to rebuttal would be unprecedented and would lend some transparency to a currently secretive process.

2013 CFIUS Annual Report

The 2013 CFIUS annual report to Congress, published in February 2015, reveals an overall expansion of CFIUS review: an increase in the number of cases submitted to the investigation stage and in the duration of CFIUS involvement in transactions under review, the latter part due to a rise in the use of mitigation measures. This expansion may push CFIUS review to become a systematic consideration for parties undertaking M&A transactions.

CFIUS review, which is usually (thought not exclusively) initiated based on the filing of voluntary notices, consists of an initial 30-day period during which the CFIUS reviews the transaction to consider its effects on US national security. If the CFIUS still has national security concerns after the initial period, a second 45-day investigation is launched. In 2013, CFIUS conducted investigations on 49 per cent of notices filed, up from 39 per cent in 2012 and 36 per cent in 2011.[67] While five transactions were submitted to investigation due to incomplete first-stage review caused by the government's shutdown in October 2013, the investigation rate would still be 44 per cent without those five transactions.[68] This inching towards the 50 per cent mark suggests that companies may soon have to assume an investigation stage review of their transaction and provide for it in their negotiations.

Mitigation measures were applied to 11 per cent of reviewed transactions in 2013, up from 8 per cent in previous years.[69] Mitigation measures are an informal practice authorising the CFIUS to enter into agreements with parties to alleviate some of the national security concerns raised by their proposed transactions. Such measures include, among others, making divestments, making modifications to agreements, ensuring only authorised personnel has access to certain technology and information and ensuring only US citizens handle certain products or services. The high-profile proposed acquisition by Chinese insurance company Anbang Insurance Group Co. of the Waldorf Astoria in New York is speculated to have cleared CFIUS review only after mitigation measures

66 *Order, Ralls Corp. v. CFIUS*, No. 12-1513 (ABJ) (D.D.C. Nov. 6, 2014).

67 Comm. On Foreign Inv. in the U.S., Annual Report To Congress (2013), 3 [hereinafter ANNUAL REPORT]; James K. Jackson, 'The Committee on Foreign Investment in the United States (CFIUS)', Congressional Research Service, 6 March 2014, www.fas.org/sgp/crs/natsec/RL33388.pdf.

68 ANNUAL REPORT at 3.

69 Id. at 21.

were included.[70] The Waldorf Astoria is home to foreign presidents visiting New York, the permanent residence of the US ambassador to the United Nations and a favourite location among foreign dignitaries and celebrities and was therefore submitted to the investigation stage of review.[71] If the CFIUS has continued oversight into the management of the Waldorf Astoria for as long as the Chinese company owns the property, the duration of its involvement could span decades. Such prolonged participation, if it rises in frequency, may push parties to an M&A transaction to address the possibility early on in the transaction process. Filing a notice to the CFIUS is a voluntary measure but the CFIUS may review a transaction at its discretion once it is completed. Measures imposed after a deal closes may affect a party's anticipated benefits and would need to be addressed.

CFIUS review is not only becoming more commonplace and more involved, it could become more costly. Failure to obtain regulatory approvals can trigger break-up fees for acquirers and the rise of CFIUS review could push more M&A parties to address it in termination fee provisions. Siemens AG will have to pay Dresser-Rand Group Inc $400 million if its acquisition does not clear review – a measure that could become practice for transactions even remotely related to national industries or concerns.[72]

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

The energy and power sector led the US market for 2014, with deal volume totalling $338.4 billion for 22.1 per cent of market share.[73] Health care followed, with dollar volume of $237.4 billion for 15.5 per cent of market share, nearly tied by media and entertainment, with dollar volume of $207.8 billion for 13.6 per cent of market share.[74]

i Hostile bids

Hostile offers made a comeback in 2014, reaching their highest level for global M&A in 14 years by the month of August.[75] By the same month, US hostile M&A had reached

70 James Rosen, 'U.S. Clears Chinese Purchase of Famed NYC Home to Presidents, Envoys, Celebs', McClatchy Washington Bureau, 3 February 2015, www.mcclatchydc.com/2015/02/03/255388/us-clears-chinese-purchase-of.html; Paul Welitzkin, 'Chinese Insurer Gets Waldorf OK', Washington Post, 3 February 2015, http://chinawatch.washingtonpost.com/2015/02/chinese-insurer-gets-waldorf-ok/.

71 Id.

72 'Implications of National Security Reviews on Foreign Acquisitions of US Business', Skadden, Arps, Slate, Meagher & Flom LLP, https://www.skadden.com/insights/implications-national-security-reviews-foreign-acquisitions-us-businesses-0 (last visited May 27 2014).

73 Mergers & Acquisitions Review, Full Year 2014, Legal Advisors, Thomson Reuters (2014), http://online.thomsonone.com.

74 Id.

75 'Hostile Takeovers Return', Financier Worldwide Magazine, August 2014, www.financierworldwide.com/hostile-takeovers-return/#.VWo4xGd0xaQ.

$221 billion, compared to $62 billion by August 2013.[76] The rise is attributed to a rise in boardroom confidence; as would-be targets trust that the worst of the economic downturn is behind them and that stock prices will remain high, they resist friendly bids in an attempt to increase premiums, pushing their would-be purchasers to turn hostile.[77] On the flip side, confident in their stability and the value of their stock and wanting to seize the currently low interest rates, would-be acquirers approach companies they had contemplated taking over during the downturn.[78] By June 2014, hostile M&A represented 19 per cent of worldwide M&A, with a combined value of $290 billion.[79] That said, $119 of that amount was attributable to Pfizer's Inc hostile, but later abandoned, bid for AstraZeneca, and by August, only $10 billion of hostile M&A had actually been completed.[80] Still, by year's end, hostile M&A represented close to 16 per cent of US M&A activity.[81]

Additionally, more hostile deals were completed in the last quarter of 2014, and, notwithstanding the success rate, the rise in hostile offers contributed to the rise in M&A deal numbers both by increasing the number of deals announced and by pushing along deals consummated in an attempt to avoid hostile takeovers. The trend spread across a variety of sectors in M&A including the top three ranking sectors. In the energy and power sector, Halliburton Company took over Baker Hughes Inc after turning hostile in November 2014 in a deal worth $38.5 billion.[82] In health care, Actavis plc bought Allergan Inc in a friendly deal worth $66.4 billion which closed in December 2014, as Allergan Inc rushed to avoid a hostile takeover by Valeant Pharmaceuticals International.[83] The largest deal of the year occurred in the media and entertainment sector – Comcast Corporation's announced acquisition of Time Warner Cable Inc for $70.7 billion – and was a friendly deal, but was largely driven by Time Warner Cable's attempt to avoid

76 David Weidner, 'Investors Sent on a Wild Ride by Hostile Deals', MarketWatch, 15 August 2014, www.marketwatch.com/story/investors-sent-on-a-wild-ride-by-hostile-deals-2014-08-15.

77 'Hostile Takeovers Return', *supra* note 75; Arash Massoudi & Ed Hammond, 'Hostile Takeovers Rise to 14-Year High in M&A as Confidence Grows', *Financial Times*, 8 June 2014, www.ft.com/intl/cms/s/0/a8a8f608-eee5-11e3-8e82-00144feabdc0.html#axzz3bf9Wi3GP.

78 Id.; Weidner, 'Investors Sent on a Wild Ride by Hostile Deals', *supra* note 76.

79 Massoudi & Hammond, 'Hostile Takeovers Rise', *supra* note 77.

80 Weidner, 'Investors Sent on a Wild Ride by Hostile Deals', *supra* note 76.

81 Ariel Deckelbaum, Frances Mi, Joseph Friedman, Yashreeka Huq, Samuel Welt, Ryan Blicher & Alison Gurr, 'M&A at a Glance – 2014 Year-End Roudup', Paul, Weiss, Rifkind, Wharton & Garrison, 15 January 2015, www.paulweiss.com/practices/transactional/mergers-acquisitions/publications/ma-at-a-glance-(2014-year-end-roundup).aspx?id=19211.

82 Liz Hoffman & Alison Sider, 'Halliburton Turns Hostile on Baker Hughes', *Wall Street Journal*, 14 November 2014, www.wsj.com/articles/oil-price-slump-spurs-halliburton-baker-hughes-talks-1416000634.

83 Jonathan Rockoff, 'Actavis Agrees to Buy Botox Maker Allergan', *Wall Street Journal*, 17 November 2014, www.wsj.com/articles/actavis-agrees-to-buy-allergan-1416233901.

Charter Communications' hostile offer.[84] When the *Time Warner/Comcast* deal failed due to antitrust concerns, Charter Communications' came back with another hostile bid in 2015, for which the outcome is still unknown.

While early 2015 has already seen some high-profile hostile offers, such as the three-way hostile offer of Teva Pharmaceutical Industries Ltd for Mylan NV, as Mylan NV attempts to take over Perrigo Company, or Simon Property Group Inc's attempt to acquire Macerich Company, the trend is not at 2014 numbers though it continues to involve the pharmaceutical and telecommunications sectors, which are set to remain among the most active in 2015.

ii Shareholder activism

In 2013 shareholder activism went mainstream; in 2014, it went big. Perhaps emboldened by their rising prominence and success – activists saw a success rate of 72 per cent in proxy fights in 2014, up from 60 per cent in 2013 – activists have invested more, targeted larger companies and sought larger changes.[85] Sixty-seven activist funds held $93 billion in 2013 and 71 held $112 billion in 2014, with total assets under activist management reported to have passed $150 billion in 2014 and potentially $200 as of early 2015.[86] Those investments have allowed activists to target more companies with market capitalization over $10 billion than in the past five years and close to three times those with market capitalization over $25 billion, including iconic entities such as Apple Inc, PepsiCo, Inc, Amgen, Inc, Walgreens Co, DuPont (E.I. du Pont de Nemours and Company), Allergan, Inc, Yahoo! Inc, Bank of New York Mellon Corp and Hertz Global Holdings Inc.[87]

The magnitude of the changes sought by activists has also been more notable. Shareholder activists have sought to replace the majority of, or even entire, boards, rather

84 Jeremy Bogaisky, 'Comcast Is Set to Snatch Time Warner Cable Away From Charter in $45B Deal', Forbes, 13 February 2014, www.forbes.com/sites/jeremybogaisky/2014/02/13/comcast-to-acquire-time-warner-cable-for-45-billion/.

85 Steven Davidoff Solomon, 'As Activist Investors Gain Strength, Boards Surrender to Demands', New York Times, 14 October 2014, http://dealbook.nytimes.com/2014/10/14/as-activist-shareholders-gain-strength-boards-surrender-to-demands/?_r=0.

86 Ronald Orol & Paula Schaap, 'Insurgencies by the Numbers', Deal Pipeline, 26 December 2014, www.thedeal.com/content/restructuring/insurgencies-by-the-numbers.php; 'Activist Investing: An Annual Review of Trends in Shareholder Activism', Schulte Roth & Zabel, www.srz.com/files/News/21059d09-ca8a-4c8d-bf07-34c275d5781d/Presentation/NewsAttachment/044cced3-43e5-4c21-8036-b6b684c34e7c/Activist_Insight_SRZ_The_Activist_Investing_Annual_Review_2015.pdf (last visited 31 May 2015).

87 Id.; 'The Actavist Revolution: Understanding and Navigating a New World of Heightened Investor Scrutiny', J.P.Morgan, January 2015, https://www.jpmorgan.com/cm/BlobServer/JPMorgan_CorporateFinanceAdvisory_MA_TheActivistRevolution.pdf?blobkey=id&blobwhere=1320675764934&blobheader=application/pdf&blobheadername1=CacheControl&blobheadervalue1=private&blobcol=urldata&blobtable=MungoBlobs.

than seeking to elect one or two directors.[88] Rather than preventing takeovers, they have pushed their companies to acquire other companies or to sell themselves, a trend which nearly doubled in 2014 as compared to 2013.[89] Darden Restaurants, Inc, Oliver Garden's and Red Lobster's parent, saw its entire board of directors replaced when shareholders called a meeting to vote on the Red Lobster sale and the board of directors rushed the sale prior to the meeting. Activist hedge fund Starboard Value LP not only advocated against the sale, but convinced shareholders to replace the board of directors with its 12 nominees once the board of directors rushed to act prior to shareholders' expressing their preference.

Some activist shareholders' effects on companies have been indirect. Activist investor Carl Icahn, eBay Inc's sixth largest shareholder, advocated for eBay to split-off PayPal in a proxy fight, which he later agreed to drop in exchange for the addition of a board member of his selection.[90] In October 2014, however, eBay independently decided to spin-off PayPal. Pershing Square Capital Management LP, Allergan Inc's largest shareholder, called an Allergan shareholder meeting hoping to remove board members and obtain approval for an Allergan sale to Valeant Pharmaceutical International Inc, which had made a hostile bid. Allergan sold itself to Actavis plc, rushing to preempt the meeting.

Activist investors have been able to extend their reach this far due to the steady erosion of structural defences and there is a concern that the constant scrutiny imposed by shareholder activists may be distracting and cause boards of directors to lose sight of the big picture as they respond to immediate pressures.

iii Appraisal arbitrage

In the wake of the Dole Food Company, Inc (Dole), management buyout, which closed in the fourth quarter of 2013, it appears hedge funds may be adding the battle for appraisal rights to their activist repertoires.[91] As hedge funds sit on large reserves of cash, they continue to seek ways to earn returns. In today's low-interest rate environment, shareholders seeking appraisal rights can obtain a meaningful return, as they are generally entitled to the fair value of their shares plus statutory interest compounded quarterly from the effectiveness of the merger until the appraisal judgement is paid.[92] Delaware's statutory interest rate is generally the Federal Reserve discount rate plus 5 per cent and

88 'Activist Investing: An Annual Review of Trends in Shareholder Activism', *supra* note 86.

89 Id.

90 Deepa Seetharaman & Supantha Mukherjee, 'EBay Follows Icahn's Advice, Plans PayPal Spinoff in 2015', Reuters, 30 September 2014, www.reuters.com/article/2014/09/30/us-ebay-divestiture-idUSKCN0HP13D20140930.

91 Steven M. Davidoff, 'A New Form of Shareholder Activism Gains Momentum', New York Times, 4 March 2014, http://dealbook.nytimes.com/2014/03/04/a-new-form-of-shareholder-activism-gains-momentum/?_php=true&_type=blogs&_r=0.

92 William Savitt, 'Dissenters Pose Bigger Risks to Corporate Deals', *National Law Journal*, 10 February 2014, www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.23132.14.pdf.

is higher than any rate available in the market.[93] While appraisal rights are generally not a lucrative pursuit for the average shareholder, activist funds have the resources to make it worth their while and the values involved keeps rising. Appraisal arbitrage claims were valued at $1.5 billion in 2013, an eightfold increase from 2012.[94] In 2014, an unprecedented 33 appraisal claims were filed in Delaware courts, compared with 28 in 2013 and the most since 2004, if not earlier.[95] Approximately 81 per cent of Delaware appraisals that went to trial since 1993 obtained higher prices.[96]

A recent Delaware Court of Chancery decision failed to ensure these appraisal arbitrage claims only protect the minority of shareholders who did not favor a deal when it found that there was no requirement that the claimant show the specific shares it seeks appraisal of voted against the deal.[97] The claimant must instead only show that more shares were voted against the merger than the number of shares it seeks appraisal of, leaving open the door for use of the practice by hedge funds.[98]

A 2015 amendment approved by the Executive Committee of the State of Delaware Bar Association, but not yet passed into law, proposes two changes to curb the amounts involved in appraisal arbitrage. The first amendment to Section 262 of the DGCL would impose a *de minimis* exception, allowing only claims where either (i) more than 1 per cent of the outstanding shares entitled to appraisal perfect their appraisal rights or (ii) the value of the merger consideration for the shares with perfected appraisal rights exceeds $1 million. The provision would not apply to certain short-form mergers and would apply only to shares listed on a national exchange. The second amendment to Section 262 would allow a corporation to prepay the claimant any portion of the transaction price, therefore limiting the principal on which interest accrues while the claim is disputed. The amendment has not yet been passed and it still fails to prevent appraisal arbitrage by parties who may have voted in favour of a deal and who subsequently seek appraisal of all their shares to obtain the settlement (companies settling with arbitrageurs to prevent litigation) or interest benefits.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Credit markets failed to show the same vigour in 2014 as the previous year. US debt capital markets saw a decrease in high-yield debt issuances, with 2014 proceeds down

93 Id.

94 Liz Hoffman, 'Hedge Funds Wield Risky Legal Ploy to Milk Buyouts', *Wall Street Journal*, 13 April 2014, http://online.wsj.com/news/articles/SB10001424052702303887804579500013770163966.

95 Liz Hoffman, 'Judges Rules in Favor of Hedge Fund 'Appraisal Arbitrage' Strategy', *Wall Street Journal*, 7 January 2015, www.wsj.com/articles/judge-rules-in-favor-of-hedge-fund-appraisal-arbitrage-strategy-1420571897.

96 Id.

97 *In re Appraisal of Ancestry.com, Inc.*, C.A. No. 8173-VCG (Del. Ch. Jan. 5, 2015) and *Merion Capital LP v. BMC Software, Inc.*, C.A. No. 8900- VCG (Del. Ch. Jan. 5, 2015).

98 Id.

6.0 per cent as compared to 2013, for a total of $307.4 billion.[99] 2014 dollar volume of US investment grade debt issuances inched past 2013's all-time high, exceeding the $1 trillion mark for the third year in a row with $1.1 trillion, up 9 per cent from the previous year.[100] Overall US syndicated lending was stagnant from 2013, up 1 per cent over 2013 levels, with total dollar volume of $2.3 trillion.[101] US leveraged lending slightly decreased from 2013, which was the best year since the credit boom, with US leveraged loan volume dropping down 7 per cent from $1.22 trillion to $1.2 trillion.[102] Unlike the previous year, bolstered by a single transaction (Verizon Communications Inc's acquisition of Verizon Wireless Inc), 2014 was driven by multiple mega-deals in the financing realm as well as the M&A realm. The top three financings were Actavis plc's acquisition of Allergan Inc with a syndicated loan of $36.4 billion, followed by Medtronic Inc's $16.3 billion loan to purchase Covidien PLC and Merck KGaA's $15.6 billion loan to acquire Sigma-Aldrich Corp.[103] On the bond side, there were 23 bond deals over $5 billion worldwide in 2014, more than double the number from 2013, with Medtronic Inc's $17 billion offering and Apple Inc's $12 billion representing two of the top 10 deals on record.[104] The bond market was heavily driven by M&A activity, with acquisition-related bond deals in 2014 representing half the largest corporate bond sales.[105]

Syndicated lending crashed at the start of 2015, with first quarter overall US syndicating lending and US leveraged loan values decreasing 17.2 per cent and 51 per cent, respectively, as compared to the first quarter of 2014.[106] Debt capital markets saw a further surge in investment grade debt, up 7.9 per cent compared to the first quarter of 2014, resulting in the first largest quarterly volume on record, largely caused by the funding of Actavis plc's funding, which was the second largest bond issue on record.[107]

Despite overall stagnant credit markets, total 2014 M&A-related loan volume reached a seven-year high with $254.4 billion, the most since it reached its peak

99 Debt Capital Markets Review, Full Year 2014, Managing Underwriters, Thomson Reuters (2015), http://online.thomsonone.com.

100 Id.

101 Global Syndicated Loans Review, Full Year 2014, Managing Underwriters, Thomson Reuters (2014), http://online.thomsonone.com.

102 Id.

103 Id.

104 Sarah Krouse & Matt Turner, 'Jumbo Corporate Bond Deals Find Broad Base', Wall Street Journal, 16 December 2014, http://blogs.wsj.com/moneybeat/2014/12/16/jumbo-corporate-bond-deals-find-broad-base/.

105 Id.

106 Global Syndicated Loans Review, First Quarter 2015, Managing Underwriters, Thomson Reuters (2015), http://online.thomsonone.com.

107 Debt Capital Markets Review, First Quarter 2015, Managing Underwriters, Thomson Reuters (2015), http://online.thomsonone.com.

in 2007 with $331 billion.[108] Refinancings, which represented nearly half of US leveraged loan volume in 2013, fell from $287.3 billion to $169 billion, and dividend recapitalisation fell from its record $69.9 billion to $53.2 billion.[109]

Due to US regulators making their stance on excessive borrowing clear, with guidelines published in March 2013 (and letters sent directly to big banks in the summer of 2013) placing pressure on banks to hold the line on total leverage ratios of six times, non-bank lenders have somewhat replaced banks in the buyout market.[110] However, while the number of leveraged buyouts has dropped, the leverage buyout ratios are close to the 2007 levels.[111] Private equity firms paid an average of 9.7 times their target companies' trailing 12 months EBITDA in 2014, close to the 9.8 times they paid in 2007.[112] The trend is expected to drop, and has already done so, in 2015. As of the end of March 2015, US buyouts were at the lowest deal number for the first quarter since 2010 and the lowest dollar volume for the first quarter since 2012.[113] Private equity firms are also constrained by and concerned about regulations on leveraged ratios, and private equity deals financed with leveraged dropped in early 2015 to 21 per cent from 35 per cent from the fourth quarter of 2014 and is expected to drop further.[114]

VII EMPLOYMENT LAW

As a result of recent regulatory changes in the US, including the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in 2010 and the SEC regulations implementing that legislation, some of which are still forthcoming, shareholders of publicly traded companies in the US have been granted increased disclosure, and a louder voice, regarding the material components of such

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108 'Credit Markets Quarterly, 4th Quarter 2014', KPMG Corporate Finance LLC (2015), https://www.kpmg-institutes.com/content/dam/kpmg/globalenterpriseinstitute/pdf/2015/q4-2014-credit-markets-quarterly-update.pdf.

109 Id; 'Credit Markets Quarterly, 4th Quarter 2013', KPMG Corporate Finance LLC (2014), www.kpmginstitutes.com/advisory-institute/insights/2014/pdf/credit-market s-quarterly-update-2013-q4.pdf.

110 Gillian Tan, 'Banks Sit out Riskier Deals', *Wall Street Journal*, 21 January 2014, http://online.wsj.com/news/articles/SB100014240527023043027045793348202015300l 0, Sasha Dai, 'Deal Multiples for Leveraged Buyouts Reach 2007 Levels', *Wall Street Journal*, 31 December 2014, http://blogs.wsj.com/privateequity/2014/12/31/deal-multiple s-for-leveraged-buyouts-reach-2007-levels/.

111 Dan Primack, 'Where Did All the Big Buyouts Go?', Fortune, 3 November 2014, http://fortune.com/2014/11/03/where-did-all-the-big-buyouts-go/; Dai, 'Deal Multiples for Leveraged Buyouts Reach 2007 Levels', *supra* note 110.

112 Dai, 'Deal Multiples for Leveraged Buyouts Reach 2007 Levels', *supra* note 110.

113 Gillian Tan, 'Buyout Firms Feel Pinch From Lending Crackdown', *Wall Street Journal*, 25 March 2015, www.wsj.com/articles/buyout-shops-feel-pinch-from-lending-crackdo wn-1427304125.

114 Id.

companies' executive pay practices (including an advisory vote known as a say-on-pay or SOP vote). SOP votes on executive compensation provide a platform from which shareholders may voice their opinions about executive pay practices employed by the company. Over the past five proxy seasons in which the SOP regulations have been in effect, certain patterns and practices have emerged as new standards, although the long-term effects of the regulatory changes remain unclear.

i Say-on-pay votes and compensation adjustments

Although SOP votes are non-binding, companies have generally demonstrated concern for their outcomes. During 2012, 58 Russell 3000 companies received 'failed' SOP votes (defined as receiving 50 per cent or fewer votes in support, excluding abstentions), and during 2013 and 2014, 58 and 60 Russell 3000 companies, respectively, received failed SOP votes, many after a proxy adviser such as Institutional Shareholder Services (ISS) and Glass, Lewis & Co had recommended a 'no' vote.[115] As of late May 2015, 21 Russell 3000 companies had failed SOP votes, compared to eight Russell 3000 companies that had failed SOP votes as of mid-May 2014, and 9 per cent of companies received 'no' recommendations from ISS, as of late May 2015, compared to 11 per cent as of mid-May 2014.[116] Notably, as of mid-May 2015, only 14 Russell 3000 companies have failed SOP votes in more than one of the five proxy seasons in which the SOP regulations have been in effect, and, on average, Russell 3000 companies that have failed a SOP vote in a given year have seen a 38 per cent increase in shareholder support for the SOP proposal the following year. The small number of companies that have failed a SOP vote in multiple proxy seasons, and the significant increase in shareholder support for a SOP proposal in the year following a failed SOP vote, demonstrates that companies approach a failed SOP vote seriously and, in most instances, make substantive changes to their pay practices in response to investor concerns voiced through such failed vote.

Data suggest that companies with high CEO pay or low stock price performance, in each case, relative to their peer companies, are consistently the ones most at risk of a failed SOP vote.[117] Companies were increasingly focused on addressing this concern in recent proxy seasons, and a survey following the 2014 proxy season found that

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115 Frederic W Cook & Co, Inc, 'Executive Compensation 2012 Year in Review and Implications for 2013 and Beyond', 1 April 2013, at 1, www.fwcook.com/alert_letters/04-01-13_Executive_Compensation_2012_Year_in_Review_and_Implications_for_2013_and_Beyond.pdf; '2015 Say on Pay Results', Semler Brossy, 27 May 2015, at 3, www.semlerbrossy.com/wp-content/uploads/SBCG-2015-SOP-Report-2015-05-27.pdf. As of May 27, 2015, shareholder support for SOP proposals was 32 per cent lower at companies that received a 'no' recommendation from ISS.

116 '2015 Say on Pay Results', *supra* note 115; '2014 Say on Pay Results', Semler Brossy, 7 May 2014, at 6, www.semlerbrossy.com/wp-content/uploads/SBCG-2014-Say-on-Pay-Report-2014-05-07.pdf.

117 'How Much Does Performance Count in a Say-on-Pay Vote?', Semler Brossy, 7 January 2015, www.semlerbrossy.com/insights/how-much-does-performance-count-in-a-say-on-pay-vote/; '2014 Say-on-Pay Results, Report Update: Five Additional Companies With Support Below

companies overwhelmingly expressed their intentions to strengthen the link between pay and performance, as well as conduct a pay-for-performance analysis.[118] Indeed, many companies have altered their pay practices, at least with respect to their CEOs, presumably as a reaction to a real or perceived sense of low shareholder support for the existing programme, and there has been a noticeable shift, particularly among the largest companies, toward incentive-based pay, with more than 75 per cent of aggregate CEO compensation at companies in the S&P 1500 comprised of equity and performance-based short-term incentives.[119]

The SOP regulations have similar application to M&A transactions. Regulations grant to shareholders an advisory vote (a 'say on golden parachute' or 'SOGP' vote) approving the amounts to be paid to executives upon a change in control (triggered by most types of M&A transactions). Certain change in control benefits that historically have been relatively common in connection with such transactions (e.g., 'single-trigger' acceleration of equity-based awards and gross-ups for the golden parachute excise tax pursuant to Section 280G of the US Internal Revenue Code, which applies to certain transaction-related payments above a threshold) have been singled out by proxy advisory firms and have drawn the particular ire of shareholders.[120] ISS's published policy guidance clearly states that it will render a negative SOP vote recommendation or a 'withhold' vote recommendation for the election of directors when a 280G gross-up is included in a new change-in-control agreement, even if no M&A transaction is imminent at the time such agreement is signed.[121] In addition, more recently ISS has indicated that it will consider legacy excise-tax gross-up and single-trigger acceleration provisions in determining its recommendation on SOGP proposals.[122]

50%', Semler Brossy, 16 July 2014, at 2, www.semlerbrossy.com/wp-content/uploads/SBCG-2014-Say-on-Pay-Report-2014-07-161.pdf.

118 Stephen Miller, 'Companies Strengthen Pay-for-Performance Analyses', Society for Human Resource Management, 5 November 2014, www.shrm.org/hrdisciplines/compensation/articles/pages/pay-for-performance-factors.aspx#sthash.5oio42Ss.dpuf.

119 'Upon Closer Inspection, CEO Pay Increasingly Performance-Based', Towers Watson, 16 December 2013, www.towerswatson.com/en-US/Insights/Newsletters/Global/executive-pay-matters/2013/Executive-Compensation-Bulletin-Upon-Closer-Inspection-CEO-Pay-Increasingly-Performance-Based.

120 Cody Nelson, 'Executive Compensation Bulletin: The Changing Landscape of Golden Parachutes in a Say-on-Pay World', Towers Watson, 28 May 2015, www.towerswatson.com/en/Insights/Newsletters/Global/executive-pay-matters/2015/Executive-Compensation-Bulletin-The-Changing-Landscape-of-Golden-Parachutes-in-a-Say-on-Pay-World. The existence of these pay practices presents risks to a favorable SOGP or SOP vote, and such practices are particularly highlighted in the SOGP disclosure.

121 ISS 2015 U.S. Compensation Policy FAQ, Q&A 59, www.issgovernance.com/file/policy/2015comprehensivecompensationfaqs.pdf.

122 ISS 2015 U.S. Compensation Policy FAQ, Q&A 75, www.issgovernance.com/file/policy/2015comprehensivecompensationfaqs.pdf.

Interestingly, the most recent data on investor decisions suggest a possible decrease in the influence of proxy advisors on investor voting.[123] For example, of the 131 SOGP votes in 2014, 93.89 per cent passed, although ISS recommended against 23 per cent of SOGP proposals in that year.[124] Furthermore, many of the most important institutional investors, including Blackrock and Vanguard, have formed in-house proxy analysis and governance groups to inform their own voting decisions in lieu of depending on proxy advisory firms. [125]

ii Shareholder litigation

Through litigation, emboldened shareholders are applying increased formal pressure on companies to change their executive pay and disclosure practices. Following the adoption of the SOP regulations, the first wave of shareholder litigation focused on SOP votes that achieved less than 70 per cent support,[126] and recent shareholder litigation has additionally challenged director compensation, although not subject to a shareholder vote, specifically alleging insufficient equity plan limits on awards to directors.[127]

A flurry of plaintiff shareholder challenges to independent director compensation arose in 2014. One of these suits, *Calma v. Templeton* (more commonly referred to as *Citrix*), resulted in a change in black letter law favouring plaintiffs.[128] In *Citrix*, the Delaware Chancery Court ruled that the relatively plaintiff-friendly 'entire fairness' standard of review rather than the relatively defendant-friendly 'business judgment rule' applied to the plaintiff's derivative claim that Citrix Systems' grants of restricted stock units to its non-employee directors under its shareholder-approved equity compensation

123 Jeff McCutcheon, '2014 Trends in Executive Compensation and Governance', Board Advisory, Retrieved from www.board-advisory.com/2014-trends-in-executiv e-compensation-and-governance.

124 ISS Corporate Solutions Governance Analytics, https://ga.isscorporateservices.com. The number of votes passed increased from 86 per cent in 2013.

125 'Lessons learned and Hot Topics in Executive Compensation', Grant Thornton LLP, 29 April 2015, at 10, https://www.grantthornton.com/~/media/content-page-files/tax/pdfs/archived-webcasts/2015/04-29-hot-topics-exec-compensation.ashx; Susanne Craig, 'The Giant of Shareholders, Quietly Stirring', The New York Times, 18 May 2013, www.nytimes.com/2013/05/19/business/blackrock-a-shareholding-giant-is-quietly-stirring.html?_r=0; Joann S. Lublin and Kirsten Grind, 'For Proxy Advisers, Influence Wanes', *Wall Street Journal*, 22 May 2013, www.wsj.com/articles/SB10001424127887323336104578499554143793319.

126 ISS has designated 70 per cent as the threshold amount of support a company must receive in order for its SOP vote to be considered successful.

127 While typically directors' responsibilities, including setting their own compensation, have been protected under the business judgment rule, in *Seinfeld v. Slager*, Civil Action No. 6462-VCG (Del. Ch., filed 29 June 2012) the Delaware Chancery Court denied a motion to dismiss a claim that the directors breached their fiduciary duties by granting themselves equity awards under a shareholder-approved plan due to insufficient limits on the amount of pay that could be awarded to directors.

128 See *Calma v. Templeton*, 2015 Del. Ch. LEXIS 126 (Del. Ch. Apr. 30, 2015).

plan, when combined with cash payments, were excessive in comparison to the compensation of similarly situated directors of peer corporations.[129] The Court rejected Citrix's argument that its shareholders had ratified the compensation packages through approval of the equity compensation plan because the approved plan did not address the non-employee director compensation with sufficient specificity, even though the Citrix plans were drafted in a market-customary fashion.

iii Compensation activity in connection with corporate inversion

As previously mentioned, 2014 saw a significant increase in the number of US companies engaging in corporate inversions.[130] In 2004, Congress enacted Sections 7874 and 4985 of the US Tax Code in a push to contain the rising corporate inversion trend. These two statutes heightened the complexity of executive compensation within corporate inversion transactions. Section 7874 defines what constitutes a corporate inversion, and is further discussed below (in the section on tax law).

Section 4985 imposes a 15 per cent excise tax on stock options, restricted stock units, and other equity-based compensation held by US executives six months before and six months after the closing of an inversion transaction, unless the equity compensation is paid prior to the closing. To shield executives from this penalty, companies either engage in 'gross-ups' where they increase payouts to executives to cover their tax liabilities, or provide vesting and payment of the equity compensation prior to the closing of a deal.[131] Corporations more frequently choose the former option of grossing-up, and in some cases this tactic has resulted in shareholder dissatisfaction.[132] For example, in the 2014 Medtronic-Covidien inversion, Medtronic shareholders, including two Medtronic ex-directors and the head of Franklin Mutual Series Funds, expressed anger at the fact that top Medtronic executives would receive approximately $63 million in gross-up payments, whereas Medtronic shareholders were being forced to pay significant capital gains taxes in connection with the deal.

Though gross-up strategies associated with Section 4985 are similar to the previously discussed ISS-disapproved Section 280G gross-ups, ISS has not generally issued adverse recommendations as a result of them. Without the specter of eliciting negative ISS votes, companies have continued to use gross-ups in connection with corporate inversions.

129 Id.

130 'What's Market: 2014 Public M&A Wrap-up', *supra* note 11.

131 Lawrence Hsieh, 'Corporate Inversions Back in The News Again', *The Economist Insights,* 11 May 2015, www.economistinsights.com/opinion/corporate-inversions-back-news-again; Rakesh Sharma, 'Medtronic Avoids U.S. Taxes While Saddling Shareholders With a Hefty Tax Bill', *The Street*, 28 January 2015, www.thestreet.com/story/13024863/1/medtronic-avoids-us-taxes-while-saddling-shareholders-with-a-hefty-tax-bill.html.

132 Ajay Gupta, 'News Analysis: Grossing Up an Inversion Tax', *Tax Analysts*, 4 September 2014, www.taxanalysts.com/www/features.nsf/Features/75722BEE3E877D1685257D4F00603223?OpenDocument.

iv Looking ahead

Although predictions are always hazardous, the movements of the last few years point to areas that are almost certain to see interesting developments in the near future as a result of the changes described above. The most significant shift may emerge in the increasing engagement of companies with shareholders, as companies are expected to seek shareholder feedback on compensation programme design with greater frequency and focus on addressing the disparity between investor and management perceptions with respect to executive compensation.[133] Further changes in compensation practices may be fuelled by the ultimate adoption of SEC rules required under Dodd-Frank relating to the link between executive pay and company financial performance, as well as expected rulemaking on disclosing the ratio of CEO pay to average employee pay.[134]

Going forward, while golden parachutes will remain a feature of executive compensation, given increased shareholder activism and pressure from proxy advisers to limit excessive compensation package strategies, it is likely that companies may begin to converge toward 'a new normal' for such payments.[135] Shareholders are also likely to continue exploring other avenues for influencing the pay practices of unresponsive companies. Thus far, director re-election has not been significantly affected by failed SOP votes, although shareholders increasingly express frustration over compensation practices by voting against re-election of directors, particularly those involved in compensation decisions.[136] The practices identified as most troublesome by ISS and other proxy

133 'Shareholder Engagement: A Key Component of Improved Say-on-Pay Outcomes in 2014', Towers Watson, 12 March 2014, www.towerswatson.com/en-US/Insights/Newsletters/Global/executive-pay-matters/2014/Shareholder-Engagement-A-Key-Component-of-Improved-Say-on-Pay-Outcomes-in-2014.

134 U.S. Securities and Exchange Commission, 'SEC Proposes Rules for Pay Ratio Disclosure', 18 September 2013, www.sec.gov/News/PressRelease/Detail/PressRelease/1370539817895; U.S. Securities and Exchange Commission, 'SEC Staff Provides Additional Analysis Related to Proposed Pay Ratio Disclosure Rules', 4 June 2015, www.sec.gov/news/pressrelease/2015-109.html; Steve Seelig, Puneet Arora & Bill Kalten, 'SEC's Proposed Pay-for-Performance Disclosure Rules Will Require Companies to Perform New Pay Calculations', Towers Watson, 29 April 2015, www.towerswatson.com/en/Insights/Newsletters/Global/executive-pay-matters/2015/SECs-Proposed-Pay-for-Performance-Disclosure-Rules-Will-Require-Companies-to-Perform-New-Pay-Calcs.

135 Cody Nelson, 'Executive Compensation Bulletin: The Changing Landscape of Golden Parachutes in a Say-on-Pay World', Towers Watson, 28 May 2015, PDF available at: www.towerswatson.com/en/Insights/Newsletters/Global/executive-pay-matters/2015/Executive-Compensation-Bulletin-The-Changing-Landscape-of-Golden-Parachutes-in-a-Say-on-Pay-World.

136 Devika Krishna Kumar & Ross Kerber, 'Three Google Directors Survive Challenge Over Pay', Reuters, 3 June 2015, www.reuters.com/article/2015/06/03/us-google-compensation-iss-idUSKBN0OJ1LC20150603; Christina Rexrode & Peter Rudegeair, 'Bank of America Shareholders Rebuke Director', *Wall Street Journal*, 7 May 2015, www.wsj.com/articles/one-third-of-bank-of-america-investors-vote-against-board-member-tom-may-1431033680.

advisory firms likely will continue to disappear given the influence of proxy advisory firms on the outcome of SOP and SOGP votes, and compensation, even with respect to perquisites and other fringe benefits, is expected to continue to shift away from cash to equity and performance-based awards. It is unclear what the effect of the migration to equity and performance-based pay, coupled with the elimination of single-trigger vesting and increased shareholder engagement, will have on future M&A transactions.

VIII TAX LAW

As noted above in Section IV, last year, inversion transactions – i.e., transactions in which US companies reincorporate abroad as part of a strategic acquisition transaction – dominated the M&A landscape. Increasingly, lawmakers took note and planned a response. Three major pronouncements have come since then, and most practitioners believe more will follow. First, the IRS and Treasury Department issued a notice with important new rules governing inversions. Second, the Obama administration proposed a new series of taxes on offshore earnings of US multinational companies. Third, the Treasury Department issued proposed model treaty language that, if implemented, would affect various international tax arrangements, including those applicable to inverted companies.

i IRS Notice 2014-52

The first attempt to stem the inversion tide came on 22 September 2014, when the IRS and Treasury Department released Notice 2014-52 (the Notice). The Notice announced the US government's plan to promulgate regulations designed to do two things: (1) make it more difficult for US companies to complete inversion transactions; and (2) decrease the tax benefits arising from inversions. The Notice applies to transactions occurring on or after 22 September 2014; as a result, several planned transactions that had not yet closed (including, as discussed in Section IV, *Cosmo/Salix* and *AbbVie/Shire*) were terminated.

Recall that an inversion transaction is a business combination between a US company and a foreign company in which both companies' shareholders become shareholders in a foreign corporation. Often, a new foreign holding company (foreign holdco) is formed to acquire the US company and the foreign company. One important requirement for an inversion transaction is that the shareholders of the US company must own less than 80 per cent of the stock of the foreign holdco (by vote and value) after the transaction.

The Notice makes it more difficult to keep the US shareholders under this 80 per cent threshold in two ways. First, in an 'anti-shrinking' rule, the Notice sets forth a complicated mechanical test for disregarding a portion of the US company's distributions in the three years before the transaction. The idea is to prevent US companies from 'shrinking' by paying large dividends (or completing large share repurchases) in advance of the transaction. Second, in an 'anti-stuffing' rule, the Notice provides that if the foreign target has more than 50 per cent gross assets consisting of cash, marketable securities and other similar assets, then a proportionate share of the foreign holdco stock issued to the foreign company shareholders will be disregarded. This rule is designed to prevent the

creation of a foreign 'cash box' that is later used as vehicle with which a US company can complete an inversion – such as the inversion between Perrigo Company and Elan Corporation plc, in which Elan (the smaller Irish company) had previously sold many of its business assets for cash.

In addition to making it more difficult to invert in the first place, the Notice also makes it less beneficial to do so. Before the Notice, one clear benefit of inverting was that it allowed the US company to access foreign earnings without subjecting them to US tax. This could be achieved by loaning 'trapped cash' held by the foreign subsidiary up to the foreign holdco or one of its foreign affiliates. Under the Notice, however, it is virtually impossible for US companies to access trapped cash; such a loan would be taxed as a deemed repatriation of that cash into the United States, triggering a US tax. And the Notice creates a similar 'deemed dividend' rule for other techniques that would result in the transfer of a foreign subsidiary out from under the US company. As a result, one of the key short-term value drivers of inversions – the ability to access 'trapped cash' with minimal or no US tax cost – has now been curtailed.

In addition to these changes, the Notice also warned that the IRS and Treasury Department were reviewing other techniques often used in conjunction with inversions, such as 'earnings stripping' and sophisticated treaty planning. Ominously, the Notice indicated that future rules limiting the use of those techniques may apply retroactively to inversion transactions completed on or after 22 September 2014.

ii New revenue proposals

In February 2015, five months after the Notice was issued, the Treasury Department released its Fiscal Year 2016 Revenue Proposals (the Revenue Proposals).[137] The Revenue Proposals include tax reforms that, if implemented, would have important implications for US corporations with foreign subsidiaries.

The Revenue Proposals are aimed at taxing the 'trapped cash' discussed above. US corporations are taxed on income earned worldwide, but when a US-based multinational corporation earns income through a foreign subsidiary, that income generally is not taxed in the United States until the subsidiary repatriates the income as a dividend or a loan to the US parent. Predictably, this policy (along with favourable financial accounting treatment) creates incentives for corporations to reinvest offshore earnings in ongoing foreign operations rather than bringing that cash back to the United States. Because the United States has one of the highest top marginal corporate income tax rates in the world, the benefits of deferring taxation can be substantial.

The Revenue Proposals reduce the top marginal corporate income tax rate from 35 per cent to 28 per cent for all US corporations and finance that rate cut by eliminating the deferral on unrepatriated offshore earnings. Foreign earnings instead would be taxed on a current basis at a minimum rate of 19 per cent, with a credit for 85 per cent of foreign taxes already paid. Thus, a subsidiary earning income in any country with an

137 U.S. Dep't of the Treasury, General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals, February 2015, www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx.

effective tax rate greater than 22.35 per cent would pay no US tax; tax paid abroad at an effective rate less than 22.35 per cent would be 'topped up' with US tax to meet the 19 per cent minimum. No additional US tax would be imposed if offshore profits ultimately are repatriated.[138] This new tax on future foreign profits would generate an estimated $238 billion over the next ten years.[139] This is no small amount, either in absolute or relative terms; as a point of reference, the federal government raised just under $321 billion in income tax from all corporate taxpayers in 2014, up from $274 billion in 2013.[140]

Additionally, the Revenue Proposals include a one-time 14 per cent tax on the $2.119 trillion[141] in previously untaxed accumulated offshore profits.[142] This one-time tax would generate an estimated $268 billion over the next 10 years,[143] which would be used to fund part of a $478 billion infrastructure project.[144]

If the Revenue Proposals become law, corporations with the largest offshore cash stockpiles – such as Microsoft, Pfizer and Apple, which held at least $76.4, $69.0, and $54.4 billion in unrepatriated profits in 2013, respectively[145] – would face a massive, unanticipated tax bill. Although affected companies would have five years to pay the one-time tax bill,[146] those that have reinvested their foreign profits in ongoing operations and have little cash actually on hand could face considerable cash-flow issues.[147]

The Revenue Proposals have been met by an overwhelmingly critical response by policy analysts, financial journalists, and executives of multinational corporations

138 Id. at 21.

139 Katherine Chiglinsky & Thomas Black, 'GE, Pfizer Face $506 Billion Foreign-Cash Tax in Obama Plan', BloombergBusiness, 2 February 2015, www.bloomberg.com/news/articles/2015-02-02/ge-microsoft-face-506-billion-foreign-profit-tax-in-obama-plan.

140 U.S. Dep't of the Treasury, Monthly Treasury Statement of Receipts and Outlays of the United States Government 5 tbl.3 (2014), www.fiscal.treasury.gov/fsreports/rpt/mthTreasStmt/mts0914.pdf.

141 Nick Timiraos & John D. McKinnon, 'Obama Proposes One-Time 14% Tax on Overseas Earnings', *Wall Street Journal*, 2 February 2015, www.wsj.com/articles/obama-proposes-one-time-14-tax-on-overseas-earnings-1422802103 (see figure titled 'Piling Up,' graphing annual trends in 'foreign indefinitely reinvested earnings').

142 2016 Revenue Proposals, *supra* note 137, at 23.

143 Chiglinsky & Black, 'GE, Pfizer face $506 Billion Foreign-Cash Tax in Obama Plan', *supra* note 139.

144 2016 Revenue Proposals, *supra* note 137, at 23.

145 Rupert Neate, 'Barack Obama Sets Out Plan to Tax US Companies on $2tn Profits Held Abroad', Guardian, 2 February 2015, www.theguardian.com/us-news/2015/feb/02/barack-obama-tax-profits-president-budget-offshore (quoting statistical analysis by Capital Economics).

146 2016 Revenue Proposals, *supra* note 137, at 23.

147 Kyle Pomerleau, 'The President's Tax on Offshore Earnings Represents the Worst of Retroactive Tax Policy', Tax Policy Blog, 2 February 2015, http://taxfoundation.org/blog/president-s-tax-offshore-earnings-represents-worst-retroactive-policy.

holding substantial amounts of offshore cash. Commentators observe that US-based multinational corporations already operate at a disadvantage compared to competitors based in countries with territorial tax systems and argue that imposing new taxes on US companies will only further encourage those companies to pursue inversions.[148] Additionally, they point out that taxing domestic earnings at 28 per cent and foreign earnings at 19 per cent would penalise US corporations that earn more income domestically relative to peer corporations with multinational operations.[149] Others decry the one-time 14 per cent tax on accumulated offshore profits as an unfair retroactive tax that 'would subject decades' worth of past economic decisions by these businesses to taxation' and 'may make taxpayers question the stability of tax laws and regulations going forward.'[150]

In any event, most political commentators think that the proposed reforms are unlikely to be enacted by the current Congress, both houses of which are controlled by Republicans. One commentator described the proposals as a 'game that politicians of both parties...have been playing for years';[151] another described them as 'dead on arrival in Congress.'[152]

iii Proposed treaty changes

As mentioned above, in Notice 2014-52, the IRS and Treasury warned of future guidance aimed at curtailing reliance on US income tax treaties in structures that erode the US tax base. One example of such a structure involves 'earnings stripping,' a technique used commonly by foreign companies (including foreign companies resulting from inversions) that have US subsidiaries. Earnings stripping involves a US subsidiary of the foreign company issuing debt to its foreign parent company (or one of its foreign affiliates). Subject to certain limitations, the interest on the debt is deductible in the United States, providing a 35 per cent federal tax benefit, but is taxed in the hands of the affiliate at a much lower rate (depending on the local rules of the affiliate's jurisdiction). Moreover, under the income tax treaty between the United States and the affiliate's jurisdiction, the

148 See, e.g., David Kocieniewski, 'Companies Too Big to Invert Would Take Brunt of Obama Tax Plan', *BloombergBusiness*, 4 February 2015, www.bloomberg.com/news/articles/2015-02-04/companies-too-big-to-invert-would-take-brunt-of-obama-tax-plan; Tiernan Ray, 'Intel CFO: Obama Repatriation Tax Proposal 'Lipstick on a Pig', Barron's, 4 February 2015, http://blogs.barrons.com/techtraderdaily/2015/02/04/intel-cfo-obama-repatriation-tax-proposal-lipstick-on-a-pig (interview with Intel's CFO, Stacy Smith).

149 See Howard Gleckman, 'Do Obama's Corporate Tax Proposals Add Up?', *Forbes*, 4 February 2015, www.forbes.com/sites/beltway/2015/02/04/do-obamas-corporate-tax-proposals-add-up.

150 Pomerleau, 'The President's Tax on Offshore Earnings', *supra* note 147.

151 Id.

152 Jeremy Scott, 'Obama's Foreign Earnings Tax: 19% Minimum DOA but Deemed Repatriations Key', *Forbes*, 5 February 2015, www.forbes.com/sites/taxanalysts/2015/02/05/obamas-foreign-earnings-tax-19-minimum-doa-but-deemed-repatriations-key.

US withholding tax rate on interest is zero per cent, and so the structure results in no US tax on the interest paid offshore.

On 20 May 2015, the IRS and Treasury announced new proposed model treaty provisions to combat this sort of planning. While certain provisions are clearly aimed at inversions, others would apply more generally. For example, a significantly revised article governing 'limitations on benefits' (LOB) would change drastically which foreign companies are eligible for benefits of US treaties. Under the proposed LOB provisions, publicly traded companies resident in a foreign country would be eligible for treaty benefits only if either (1) the company's shares are 'primarily traded' on an exchange located in the foreign country or (2) the 'primary place of management and control' is in the foreign country. On (1), this means that companies traded primarily on NYSE or NASDAQ would not qualify for treaty benefits. On (2), note that the 'primary place of management and control' test is very different from 'effective management and control' under many local foreign laws. The latter often looks mainly (if not exclusively) to where board meetings take place; the former, however, is defined in the model treaty itself, and generally requires that executives and management of the foreign company (and their administrative and support staffs) work more in the foreign country of residence than anywhere else.

For inverted US companies now operating as foreign companies, these heightened LOB requirements are likely to create serious commercial and operational issues. Many inverted companies continue to be traded on NYSE or NASDAQ, so the 'primarily traded' test will not be met. (Meeting it would require listing on a foreign exchange and having that exchange be the primary place of trading, which may be commercially and financially undesirable for companies and investors alike.) And as for moving management and staff overseas to satisfy the 'primary management and control' test, this generally has not been the practice of inverted companies.

These revised LOB provisions are clearly an attempt by the IRS and Treasury to make sure that foreign companies benefit from US income tax treaties only if they have more significant substance abroad than is required under current law. They are clearly aimed, at least in part, at US companies that have reorganised overseas by completing inversion transactions. Nevertheless, the LOB provisions themselves would apply to any foreign company, inverted or not, seeking to benefit from a treaty containing such an LOB provision.

Aside from the LOB provisions, which would apply to all foreign companies, the revised model treaty provisions also target inverted companies specifically. Under the model treaty provision, important treaty benefits (e.g., benefits of reduced US withholding rates on interest, dividends, royalties and 'other income') are unavailable to US companies completing inversion transactions for a period of ten years after the inversion. This would apply even for payments made to unrelated persons. So, for example, if a US company were to complete an inversion transaction (becoming a subsidiary of a foreign company), it would not be able to benefit from reduced withholding rates under treaties for ten years after the inversion. This could raise borrowing costs for such US companies, because the universe of lenders that could lend to them on a withholding-free basis would be much smaller than that which currently exists. (Almost all banks in treaty jurisdictions would either choose not to lend or would demand a gross-up.)

Finally, the treaty provisions also take aim squarely at earnings stripping. Even if the LOB provisions were satisfied, treaty benefits would be denied for interest, dividends and similar payments paid to a related party where the payments benefit from a 'special tax regime' in the jurisdiction of the recipient of the payment. This would prevent the erosion of the US tax base through deductible payments without a significant amount of offsetting tax in the treaty jurisdiction. Even this proposal, however, takes aim at more than just inverted companies; by denying benefits even for non-inverted groups, it would likely discourage even cash takeovers of US companies by foreign companies.

iv Conclusion

This much is clear: the inversion frenzy has abated since last year. But we are far from reaching a new point of stability in the US international tax system. The IRS and Treasury will doubtless continue to use all tools at their disposal to preserve the United States' interest in taxing worldwide income of its corporations, including 'trapped cash' in foreign subsidiaries. And US corporations will continue to exploit the existing rules to their advantage. If history is any guide, this high-stakes cat-and-mouse game will continue, probably for many years, until lawmakers in the legislative and executive branches can craft a solution that attracts the necessary political support to create new laws.

IX COMPETITION LAW

In the past year the Antitrust Division of the Department of Justice (DoJ) and the Federal Trade Commission (FTC, and together with the DoJ, 'the agencies') have continued to carefully examine potential anti-competitive effects of all types of transactions involving a wide variety of industries, and have litigated a number of high-profile merger challenges in federal court at the trial and appellate levels.[153] The FTC has focused in particular on the health-care sector, devoting significant resources over the last year to investigate health-care mergers, and, in a number of such cases, has required remedies or pursued enforcement actions, recently obtaining two favourable rulings from federal appellate courts on such challenges.[154] The agencies have also made clear that they continue to take seriously and are willing to prosecute parties for illegal premerger coordination, commonly referred to as 'gun-jumping'.[155] In 2014, the FTC brought 18 merger actions in Second Request or compulsory process investigations,[156] and the DoJ challenged,

153 See Deborah L. Feinstein, Bureau of Competition, Director's Report (Spring 2015), https://www.ftc.gov/system/files/documents/public_statements/637441/bc_directors_report_-_spring_2015.pdf.

154 Id.

155 See Press Release, Dept. of Justice, 'Justice Department Reaches $5 Million Settlement with Flakeboard, Arauco, Inversiones Angelini and Sierrapine for Illegal Premerger Coordination', 7 November 2014, www.justice.gov/atr/public/press_releases/2014/309786.htm.

156 See Fed. Trade Comm'n Fiscal Year 2014 Summary of Performance and Financial Information, https://www.ftc.gov/system/files/documents/reports/ftc-fy-2014-summar

restructured or saw the abandonment of 20 proposed transactions.[157] In 2014 through the first half of 2015, the FTC challenged 28 mergers; in most of those cases, the challenge was resolved through a negotiated remedy, allowing the merger to proceed, but in three cases the transaction was abandoned following the FTC's challenge, and in three other cases, the FTC acted to block the merger, including in *Sysco/US Foods*, which is currently being litigated in federal district court.[158]

In February 2015, the FTC increased the filing thresholds under the HSR Act. Under the new thresholds, the 'size of transaction' test will be satisfied for most transactions valued over $76.3 million (increased from $75.9 million).[159] Moreover, in March 2015, the FTC adopted revisions to its Rules of Practice. Most notably under the revised rules, the FTC will now automatically suspend administrative litigation, upon the merging parties' request, if the FTC loses a motion for a preliminary injunction in the matter in federal district court, so as to allow the FTC to determine on a case-by-case basis whether it would be in the public interest to continue pursuing the administrative litigation.[160] In terms of personnel changes since the prior edition, Francine Lafontaine was named director of the FTC's Bureau of Economics, and Alexis Gilman was promoted to Assistant Director of the Mergers IV Division.[161]

i Department of Justice

The DoJ reviewed a variety of high-profile transactions over the last year, several of which resulted in the parties abandoning the transaction after the DoJ expressed competitive concerns.

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y-performance-financial-information/150218fy14spfi.pdf.

157 See Division Update Spring 2015, Civil Program Update, www.justice.gov/atr/division-update/2015/civil-program-update.

158 See Press Release, Fed. Trade Comm'n, 'FTC Chairwoman Ramirez Testifies Before House Judiciary Subcommittee on Antitrust Enforcement and Priorities to Promote Competition and Protect Consumers', 15 May 2015, https://www.ftc.gov/news-events/press-releases/2015/05/ftc-chairwoman-ramirez-testifies-house-judiciary-subcommittee.

159 See Press Release, Fed. Trade Comm'n, 'FTC Announces New Thresholds for Clayton Act Antitrust Reviews for 2015', 15 January 2015, https://www.ftc.gov/news-events/press-releases/2015/01/ftc-announces-new-thresholds-clayton-act-antitrust-reviews-2015.

160 See Press Release, Fed. Trade Comm'n, 'Commission Approves Revisions to its Rules of Practice', 13 March 2015, https://www.ftc.gov/news-events/press-releases/2015/03/commission-approves-revisions-its-rules-practice.

161 See Press Release, Fed. Trade Comm'n, 'Francine Lafontaine Named Director of FTC's Bureau of Economics', 29 September 2014, https://www.ftc.gov/news-events/press-releases/2014/09/francine-lafontaine-named-director-ftcs-bureau-economics; Press Release, Fed. Trade Comm'n, 'Keeper league, Antitrust-Style', 2 September 2014, https://www.ftc.gov/news-events/blogs/competition-matters/2014/09/keeper-league-antitrust-style.

Comcast/Time Warner Cable

On 13 February 2014, Time Warner Cable Inc (TWC) and Comcast Corp (Comcast) announced an agreement for TWC to be acquired by Comcast in a deal valued at $45 billion.[162] At the time, the companies publicly predicted that the deal would win regulatory approval because they did not have cable subscribers in overlapping geographic regions, a prediction with which many analysts agreed both because of the lack of subscriber overlap and the proven strength of Comcast's lobbying abilities, which helped it overcome regulatory hurdles to win approval of its acquisition of a majority stake in NBCUniversal in 2011.[163] As one analysis observed, in light of these dynamics, the deal 'felt to many like a sure thing' and had an 'air of inevitability' hanging over it.[164] Comcast also offered to shed over 3 million subscribers to keep its share of the cable market below 30 per cent.[165]

In mid-April 2014, over 14 months after the deal was announced, Comcast and TWC had their first face-to-face meeting with the DoJ to discuss possible concessions that would satisfy any competitive concerns.[166] But whereas Comcast and TWC argued that the deal would not reduce consumer choice for cable services, both the DoJ and the Federal Communications Commission (FCC), with whom the DoJ was coordinating to review the transaction, were focused more on the effects of the deal in the market for broadband internet.[167] Both agencies reportedly had expressed concerns that the combined company would have significant market power in the broadband Internet market and an advantage over competitors offering online video programming, and the DoJ was reviewing whether Comcast violated an agreement, made as a condition to its acquisition of NBCUniversal, to relinquish its management rights in Hulu, the online streaming service controlled by NCBUniversal.[168] Specifically, the DoJ was investigating whether Comcast took an active role in the proposed sale of Hulu by its co-owners, 21st

162 See Cecilia Kang, 'Comcast, Time Warner Agree to Merge in $45 Billion Deal', *Washington Post*, 13 February 2014, www.washingtonpost.com/business/economy/comcast-time-warner-agree-to-merge-in-45-billion-deal/2014/02/13/7b778d60-9469-11e3-84e1-27626c5ef5fb_story.html.

163 Id.

164 See Jonathan Mahler, 'Once Comcast's Deal Shifted to a Focus on Broadband, Its Ambitions Were Sunk', *New York Times*, 23 April 2015, www.nytimes.com/2015/04/24/business/media/once-comcasts-deal-shifted-to-a-focus-on-broadband-its-ambitions-were-sunk.html?action=click&contentCollection=Media&module=RelatedCoverage®ion=Marginalia&pgtype=article.

165 Kang, 'Comcast, Time Warner Agree to Merge', *supra* note 162.

166 See Shalina Ramachandran, Joe Flint & Brent Kindall, 'Comcast Strives to Save Merger With Time Warner Cable', *Wall Street Journal,* 19 April 2015, www.wsj.com/articles/comcast-and-time-warner-cable-to-meet-with-doj-to-negotiate-merger-1429410969.

167 Id.

168 Id.; see also Press Release, Dept. of Justice, 'Justice Department Allows Comcast-NBCU Joint Venture to Proceed With Conditions', 18 January 2011, www.justice.gov/atr/public/press_releases/2011/266149.htm.

Century Fox Inc and Walt Disney Co, by playing a role in the parties ultimately deciding not to sell the service.[169] With the DoJ's focus on potential effects of the transaction in the broadband market, the fact that the companies lacked subscriber overlap in the cable market no longer ensured a straight path to approval. Commentator also noted a political dynamic at play: the Obama administration had come out in support of 'net neutrality' – the principle that internet providers should treat all internet traffic equally – and '[a]t the end of the day, the government's commitment to maintaining a free and open Internet did not square with the prospect of a single company controlling as much as 40 per cent of the public's access to it'.[170]

On 24 April 2015, just days after the companies' meetings with federal regulators, Comcast announced that it was abandoning the deal as a result of regulatory pressure.[171] According to reports, the FCC told the companies that it was prepared to submit the case to an administrative law judge, which would likely have resulted in significant delays, and Attorney General Eric Holder reportedly had authorised the DoJ attorneys reviewing the deal to challenge it.[172] In announcing Comcast's abandonment of the deal, Attorney General Holder confirmed that the DoJ had 'informed the companies that it had significant concerns that the merger would make Comcast an unavoidable gatekeeper for Internet-based services that rely on a broadband connection to reach consumers', and that, in DoJ's view, '[t]he companies' decision to abandon the deal is the best outcome for American consumers'.[173]

Flakeboard/SierraPine

On 1 October 2014, Flakeboard American Ltd (Flakeboard) abandoned its plan to acquire three mills from SierraPine after the DoJ expressed concerns about the transaction's likely competitive effects in the market for medium-density fibreboard (MDF), a manufactured wood product used in furniture, kitchen cabinets and decorative mouldings.[174] According

169 See Ramachandran, Flint & Kindall, 'Comcast Strives to Save Merger With Time Warner Cable', *supra* note 166.

170 See Mahler, 'Once Comcast's Deal Shifted to a Focus on Broadband', *supra* note 164.

171 See Press Release, Dept. of Justice, 'Comcast Corporation Abandons Proposed Acquisition of Time Warner Cable After Justice Department and the Federal Communications Commission Informed Parties of Concerns', 24 April 2015, www.justice.gov/opa/pr/comcast-corporatio n-abandons-proposed-acquisition-time-warner-cable-after-justice-department.

172 See Emily Steel, 'Under Regulators' Scrutiny, Comcast and Time Warner Cable End Deal', *New York Times*, 24 April 2015, www.nytimes.com/2015/04/25/business/media/ comcast-time-warner-cable-deal.html?action=click&contentCollection=Media&module=Rela tedCoverage®ion=Marginalia&pgtype=article.

173 See Press Release, Dept. of Justice, 'Comcast Corporation Abandons Proposed Acquisition of Time Warner Cable After Justice Department and the Federal Communications Commission Informed Parties of Concerns', 24 April 2015, www.justice.gov/opa/pr/comcast-corporatio n-abandons-proposed-acquisition-time-warner-cable-after-justice-department.

174 See Press Release, Dept. of Justice, 'Flakeboard Abandons Its Proposed Acquisition of SierraPine', 1 October 2014, www.justice.gov/atr/public/press_releases/2014/309005.htm.

to the DoJ, Flakeboard and SierraPine are two of only four significant suppliers of MDF to the West Coast and are the two closest sellers for many MDF customers.[175] The DoJ analysed effects in a market for 'thicker and denser grades of MDF' sold on the West Coast and claimed that, post-transaction, Flakeboard would have a 58 per cent share of that market.[176] The DoJ found both unilateral and coordinated effects likely – by eliminating the head-to-head competition between the companies on the West Coast, the DoJ claimed, Flakeboard would have a greater ability to increase prices as well as coordinate with its few remaining rivals.[177]

The case is particularly notable for what happened after Flakeboard abandoned the proposed transaction. On 7 November 2014, the DoJ announced that it had filed in federal district court and, the same day, settled a complaint alleging that the companies violated the HSR Act and Section 1 of the Sherman Act through unlawful pre-merger coordination.[178] According to the complaint, after announcing the proposed acquisition in January 2014, and before the expiration of the waiting period under the HSR Act, Flakeboard and SierraPine illegally coordinated to close one of the three mills included in the deal, and move the mill's customers to Flakeboard, leading to the permanent shutdown of the SierraPine mill and enabling Flakeboard to secure a significant number of the mill's former customers – in short, the parties prematurely transferred to Flakeboard operational control, and therefore beneficial ownership, of the SierraPine mill before the DoJ concluded its review of the proposed transaction, thus violating the HSR Act.[179]

Each party in a transaction is subject to a maximum civil penalty of $16,000 per day for each day the party is in violation of the HSR Act.[180] In this case, the proposed settlement required the companies to pay a combined $3.8 million in civil penalties, less than the maximum applicable penalty, and establish antitrust compliance programs; Flakeboard also was required to disgorge $1.15 million in profits.[181] In announcing the settlement, the DoJ noted that it had decided to reduce the maximum penalty in light of the fact that the companies voluntarily provided DoJ with evidence of their unlawful conduct.[182] Even with that reduction, however, the settlement resulted in the second-largest civil penalty for pre-merger coordination in DoJ history.[183]

175 Id.

176 Id.

177 Id.

178 See Press Release, Dept. of Justice, 'Justice Department Reaches $5 Million Settlement With Flakeboard, Arauco, Inversiones Angelini and SierraPine for Illegal Premerger Coordination', 7 November 2014, www.justice.gov/atr/public/press_releases/2014/309786.htm.

179 Id.

180 Id.

181 Id.

182 Id.

183 See Division Update Spring 2015, Civil Program Update, www.justice.gov/atr/division-update/2015/civil-program-update.

ii Federal Trade Commission

In 2014, the FTC continued to demonstrate its willingness to challenge transactions that it believes are likely to reduce competition and increase prices, whether in local geographic markets or in national markets, or both. This past year saw the FTC challenge a number of high-profile transactions involving a wide range of industries, including its attempt to block the proposed merger between Sysco Corporation (Sysco) and US Foods Inc (US Foods), which is still being litigated in federal district court, and several cases involving healthcare mergers, including two cases in which the FTC received favourable rulings from a court of appeals.

Sysco/US Food

On 19 February 2015, over a year after it initiated its investigation of the deal, the FTC filed an administrative complaint to prevent the proposed merger of Sysco and USF Holding Corp and US Foods, Inc, the two largest broadline foodservice distribution services in the United States.[184] The administrative complaint alleges that the merger would significantly reduce competition nationwide and in 32 local markets for broadline foodservice distribution services, causing entities such as restaurants, hospitals, hotels and schools to face higher prices and diminished customer service.[185] Broadline foodservice distributors provide extensive product lines for their foodservice customers, including both national brands and private-label products. Sysco and US Foods' strong national presence also allow them to provide frequent delivery to their customers, as well as various high-level customer services such as order tracking and menu planning. According to the FTC, the proposed merger would eliminate the pervasive head-to-head competition between the two 'best and most often used' broadline distributors in both national and local markets.[186] Combined, Sysco and US Foods account for 75 per cent of the national market for these distribution services.[187] The FTC alleged that the parties' agreement violated Section 5 of the FTC Act and that the merger would, if completed, violate Section 7 of the Clayton Act. The complaint highlighted the distinct services that broadline distributors provide, which allow their customers to have consistency in pricing, service, ordering and products.[188] According to the FTC, these services are not easily substituted by other forms of foodservice distribution such as specialty distributors, which carry only limited product lines, or cash-and-carry stores, which do not deliver.[189]

Prior to the filing of the complaint, US Foods proposed a divestiture package whereby it would divest 11 distribution centers to rival Performance Food Group,

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184 Press Release, Fed. Trade Comm'n, 'FTC Challenges Proposed Merger of Sysco and US Foods', 19 February 2015, https://www.ftc.gov/news-events/press-releases/2015/02/ftc-challenges-proposed-merger-sysco-us-foods.

185 Id.

186 See Complaint at 4, 17, *In the Matter of Sysco/USF Holding/US Foods*, No. 9364 (FTC 19 February. 2015).

187 See id. at 3.

188 Id. at 2.

189 See id. at 8.

the industry's next-largest company after US Foods and Sysco, with 5 per cent of the national market.[190] According to the FTC, however, the plan would not 'restore the competition lost by eliminating US Foods as an independent competitor', and would thus not remedy the competitive harm of the merger.[191]

On 20 February 2015, the FTC filed a complaint in federal court in the district of Columbia, seeking a temporary restraining order and preliminary injunction to prevent the proposed merger pending the outcome of the administrative proceeding.[192] The complaint was filed jointly with the state Attorneys General of California, Illinois, Iowa, Maryland, Minnesota, Nebraska, Ohio, Pennsylvania, Tennessee, Virginia and the district of Columbia. The defendants stipulated on 27 February 2015 that they would not consummate the proposed merger until the court rules on the FTC's motion.[193] An evidentiary hearing was held on 5 May 2015, and continued to 14 May 2015. The evidentiary hearing underscored the importance to the FTC's case of customer reaction to the deal. The FTC relied heavily on complaints from customers of both Sysco and US Foods that the proposed merger would leave them with significantly less effective alternatives, as well as the risk that Sysco would have less incentive to maintain its high quality of customer service.[194] Ultimately, the FTC called five customers currently contracting with US Foods in either national or local markets as witnesses during the evidentiary hearing. Sysco and US Foods disputed the FTC's contention that the merger would reduce options and raise prices for foodservice customers, countering that this view of the relevant market ignored both the thousands of food distributors that compete for these businesses as well as the effect of the financial crisis on the growth of the foodservice industry.[195] Commentators have noted that the key deciding factor in the federal court's ruling will be how it interprets the food distribution marketplace, and whether broadline distributors like Sysco and US Foods are indeed distinct from specialty distributors or other types of wholesale food suppliers.[196] Oral argument on the preliminary injunction was held on 28 May 2015. The court has yet to rule on the FTC's motion.

190 Id. at 5.

191 Id.

192 See Complaint for Temporary Restraining Order and Preliminary Injunction at 1-2, *FTC v. Sysco Corporation*, No. 15-cv-00256 (APM) (D.D.C. 20 February 2015).

193 See Stipulation and Order, *FTC v. Sysco Corporation*, No. 15-cv-00256 (APM) (D.D.C. 27 February 2015).

194 See Complaint for Temporary Restraining Order and Preliminary Injunction at 8, *FTC v. Sysco Corporation,* No. 15-cv-00256 (APM) (D.D.C. 20 February 2015).

195 See Brett Kendall, 'US Foods Will Kill Sysco Deal if Court Delays Merger, Executive Says', *Wall Street Journal*, 11 May 2015, www.wsj.com/articles/top-sysco-executive-defends-us-foods-deal-in-court-testimony-1431369386.

196 See, e.g., Brett Kendall, 'Sysco-US Foods Merger Hinges on Judge's Interpretation of Marketplace', *Wall Street Journal*, 5 May 2015, www.wsj.com/articles/sysco-us-foods-merger-hinges-on-judges-interpretation-of-marketplace-1430852128.

St. Luke's/Saltzer

As discussed in the prior edition, on 12 March 2013, the FTC and the Idaho Attorney General jointly filed a complaint in federal district court seeking a permanent injunction to unwind St. Luke's Health System Ltd (St. Luke's) acquisition of Saltzer Medical Group, PA (Saltzer), Idaho's largest independent, multi-specialty physician practice group.[197] St. Luke's had acquired the assets of Saltzer on 31 December 2012, in a non-HSR reportable transaction.[198] The *St. Luke's* case went to trial in late 2013, and on 24 January 2014, the federal district court ruled in favour of the FTC, holding that the acquisition violated Section 7 of the Clayton Act and the Idaho Competition Act.[199] The court found that the substantial post-acquisition market share of St. Luke's would give it a dominant bargaining position over health plans and that it was highly likely that St. Luke's would use that market power to receive increased reimbursements, which would result in higher premiums and deductibles for consumers.[200] St. Luke's was ordered to fully divest all Saltzer physicians and assets and 'take any further action needed to unwind the acquisition'.

On 10 February 2015, the Ninth Circuit affirmed the district court's ruling.[201] As the FTC noted in its press release regarding the affirmance, the Ninth Circuit's decision offers 'many lessons...about the interpretation and application of Section 7' of the Clayton Act,[202] particularly with respect to the availability and scope of the so-called 'post-merger efficiencies defense'. On appeal, St. Luke's rebuttal of the FTC's *prima facie* case focused on the contention that the merger would allow it to move toward integrated care and risk-based reimbursement, resulting in higher quality, lower cost health care for consumers. Addressing this argument, the Ninth Circuit noted that other circuits have 'suggested that proof of post-merger efficiencies could rebut a Clayton Act Section

197 Press Release, Fed. Trade Comm'n, 'FTC and Idaho Attorney General Challenge St. Luke's Health System's Acquisition of Saltzer Medical Group as Anticompetitive', 12 March 2013, www.ftc.gov/news-events/press-releases/2013/03/ftc-and-idaho-attorney-general-challenge-st-lukes-health-systems.

198 See Complaint for Permanent Injunction at 8, *FTC and State of Idaho v. St. Luke's Health System, Ltd and Saltzer Medical Group, P.A.*, No. 13-cv-116-BLW (D. Idaho 26 March 2013).

199 Press Release, Fed. Trade Comm'n, 'Statement of FTC Chairwoman Edith Ramirez on the U.S. District Court in the District of Idaho Ruling in the Matter of the Federal Trade Commission and the State of Idaho v. St. Luke's Health System Ltd. and Saltzer Medical Group, P.A.', 24 January 2014, www.ftc.gov/news-events/press-releases/2014/01/statement-ftc-chairwoman-edith-ramirez-us-district-court-district.

200 See Findings of Fact and Conclusions of Law at 27, *FTC and State of Idaho v. St. Luke's Health System, Ltd. and Saltzer Medical Group, P.A.*, No. 1:13-cv-00116-BLW (D. Idaho 24 January 2014).

201 See *St. Alphonsus Med. Center-Nampa Inc. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775 (9th Cir. 2015).

202 See Press Release, Fed. Trade Comm'n, '9th Circuit Affirms: St Luke's/Saltzer Merger Violates Section 7', 10 February 2015, https://www.ftc.gov/news-events/blogs/competition-matters/2015/02/9th-circuit-affirms-st-lukessaltzer-merger-violates.

7 *prima facie* case' and that the FTC had 'cautiously recognized the defense', but no appellate decision had held that a Section 7 defendant's efficiency defence rebutted a *prima facie* case of anti-competitive effects, and 'the parameters of the defense remain imprecise'.[203] Although expressing scepticism about the defence in general and its scope in particular, the court ultimately held that the defense is available, but 'the language of the Clayton Act must be [its] linchpin': 'a successful efficiencies defense requires proof that a merger is not, despite the existence of a *prima facie* case, anticompetitive' and must establish that the efficiencies are 'extraordinary' and 'merger specific', that is, they cannot 'readily be achieved without concomitant loss of a competitor'.[204] As the court made clear, this is a significant burden for a defendant seeking to rely on the defence, one that St. Luke's was unable to overcome only with evidence that the merger would allow it to improve the delivery of health care to patients in the relevant geographic market – 'a laudible goal', but not one, the court ruled, that excuses a merger that lessens competition or creates monopolies.[205]

ProMedica/St. Luke's

The FTC achieved another victory at the appellate level in connection with its challenge of the proposed merger between ProMedica Health System Inc (ProMedica) and St. Luke's Hospital.[206] In *ProMedica Health Sys., Inc v. FTC*,[207] the Sixth Circuit upheld the FTC's order to ProMedica, the largest hospital system in Luca County, Ohio, to divest St. Luke's Hospital, an independent community hospital in the area, because the merger would leave ProMedica with more than 50 per cent of the market for primary and secondary services and more than 80 per cent of the market for inpatient obstetrical services.[208] The deal was announced in May 2010, and shortly thereafter the FTC initiated its investigation and entered a 'hold separate agreement' with ProMedica that allowed the deal to close but prohibited ProMedica from terminating St. Luke's Hospital's contracts with managed care organisations (MCOs), eliminating or transferring its clinical services or terminating its employees without cause during the pendency of the FTC's review.[209] The FTC filed an administrative complaint in January 2011, and later that month, along with the state of Ohio, filed a separate complaint in federal district court seeking a preliminary injunction that would extend the hold separate agreement pending the outcome of the administrative proceedings, which the district court granted in March 2011.[210] Later that year, the administrative law judge (ALJ) presiding over the FTC's administrative complaint found that the merger would substantially increase

203 St. Alphonsus, 778 F.3d at 789.

204 Id. at 790-91 (internal quotations and citations omitted).

205 Id. at 791-92.

206 See *Promedica Health Sys., Inc. v. FTC*, 749 F.3d 559 (6th Cir. 2014).

207 749 F.3d 559 (6th Cir. 2014).

208 Id. at 562.

209 Id. at 564.

210 Id.; see also Press Release, Fed. Trade Comm'n, 'Statement by FTC Bureau of Competition Director Richard Feinstein on the Court Ruling Granting a Preliminary Injunction in the

industry concentration, increase ProMedica's bargaining power with MCOs and allow ProMedica to increase prices above competitive levels.[211] The Commission affirmed the ALJ's decision, and the appeal to the Sixth Circuit followed.

Explaining the competitive dynamics in the relevant markets, the Sixth Circuit noted that MCOs, the direct purchasers of health-care services, 'must offer a comprehensive range of services – primary, secondary, tertiary, and quaternary – within a geographic range that patients are willing to travel for each of those services', which 'in turn create[s] leverage for hospitals to raise rates: to the extent patients view a hospital's service as desirable or even essential', for example, because of its location or its reputation, 'the hospital's bargaining power increases'.[212] In this case, the court noted, 'no MCO has offered a network that did not include either' of the merging parties, underscoring the importance of the head-to-head competition between them.[213] Moreover, the merger would result in market concentration levels that substantially exceeded the levels the agencies consider to be presumptively anticompetitive.[214] The Sixth Circuit rejected ProMedica's argument that concentration levels are not relevant in a case alleging potential harm through unilateral effects rather than coordinated effects, and held that the FTC was correct to presume the merger substantially anti-competitive in light of the post-merger concentration levels.[215]

Like the defendants in St. Alphonsus (regarding the St. Luke's merger with Saltzer described above), ProMedica also attempted to rebut the FTC's *prima facie* case; notably, however, rather than seek to demonstrate merger-specific efficiencies, ProMedica sought to rebut the FTC's case with a so-called 'flailing firm' or 'weakened competitors' defence – that is, the argument that 'St. Luke's was in such dire financial straits before the merger that it was not a meaningful competitive constraint on ProMedica'.[216] In rejecting this argument, the Sixth Circuit described it as 'the Hail-Mary pass of presumptively doomed mergers', one credited by courts 'only in rare cases' where the acquiring firm makes a substantial showing that, absent the merger, the acquired firm's market share would reduce to a level that would undermine the FTC's *prima facie* case'.[217] Although St. Luke's Hospital's pre-merger struggles were to some extent supported by the record, the court concluded that they 'provide no basis to' rebut the FTC's findings about the merger's anti-competitive effects.[218] *ProMedica* is also another example where the FTC's case was bolstered by internal party documents. For example, the court noted St. Luke's Hospital's board presentations indicating that 'a merger with ProMedica had the greatest potential

ProMedica/St. Luke's Hospital Matter', 29 March 2011, https://www.ftc.gov/news-events/press-releases/2011/03/statement-ftc-bureau-competition-director-richard-feinstein-court.

211 778 F.3d at 564.

212 Id.

213 Id.

214 Id. at 568.

215 Id. at 569-570.

216 Id. at 572.

217 Id. at 572.

218 Id.

for higher hospital rates' and would give the combined entity 'a lot of negotiating clout' over MCOs.[219] These documents along with the testimony of the parties' executives led the Sixth Circuit to observe that 'the Commission's best witnesses were the merging parties themselves'.[220]

The defendants in *ProMedica* filed a petition for Supreme Court review of the Sixth Circuit's decision, which the FTC has opposed. As the FTC has noted, if the defendants' petition is granted, it would be the first merger case before the Supreme Court on substantive grounds in over 40 years.[221]

X OUTLOOK

M&A rose close to pre-crisis levels in 2014, with mega-deals stealing the market and acquirers using inexpensive credit, increased corporate funds, finite private equity capital reserves and healthy equity markets. It seems that confidence was back and actors in large sectors such as power and energy, health care and media and entertainment have showed they have no intention of limiting their reach for more activity and bigger companies. However, the government is taking notice of large deals, whether for antitrust, tax, financial regulation or national security concerns and the start of 2015 has already suggested that M&A activity, measured by dollar volume, will slow as a result, even if M&A volume by number of deals increases. Regulation has affected the viability of certain deals and has raised concerns about the regulatory environment to come.

219 Id. at 563 (internal citations omitted).

220 Id. at 571.

221 See Deborah L. Feinstein, Bureau of Competition, Director's Report (Spring 2015), https://www.ftc.gov/system/files/documents/public_statements/637441/bc_directors_report_-_spring_2015.pdf.

Appendix 1

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