Cravath Quarterly Review
M&A, Activism and Corporate Governance

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Introduction

In the first quarter of 2020, the outbreak of COVID-19, which the World Health Organization declared a pandemic on March 11, 2020, had a devastating impact on human health and life globally. In a short period of time, the virus spread throughout the world, overwhelmed healthcare systems and resulted in tremendous loss of life. In an effort to combat the pandemic, governments around the world implemented a variety of measures targeted at slowing the spread of the virus. These measures resulted in widespread disruption to businesses worldwide and uncertainty and anxiety in the global economy. While some of the sections in this newsletter discuss certain effects of the COVID-19 pandemic, we have also prepared a series of materials regarding the impact of COVID-19 and related considerations in different areas of the legal practice that can be found here.

Mergers & Acquisitions

TRENDS[1]

After several strong years of deal making, global M&A activity in Q1 2020 was down ~39% by value compared to Q1 2019 as the effects of the COVID-19 pandemic began to ripple globally. The COVID-19 pandemic also impacted pending transactions—since the end of Q1 2020, there have been an increasing number of transactions where parties have sought termination or delay of closing or have sued in order to force the counterparty to close.[2] Even before the economic impact of the COVID-19 pandemic became widespread, deal making in the early part of 2020 was already off to a slower start. The decline in the number of megadeals (>$10 billion) in Q1 2020 was illustrative of the market volatility dampening confidence needed to make bold strategic moves. While private equity buyouts remained strong compared to Q1 2019, the ability of private equity firms to deploy capital will be tested in the quarters to come. In terms of sector activity, the Industrials and Chemicals, Financial Services and Technology sectors continued to be active compared to Q1 2019 with the Pharma, Medical & Biotech sector seeing a sharp decline in activity.

Global Deal Making Down Significantly Compared to Q1 2019

The first quarter of 2020 saw 3,685 transactions totaling $563.6 billion; a decline in value of ~39% and a decline in deal count of ~25% compared to Q1 2019 and the slowest opening quarter since the first quarter of 2013. Global M&A activity slowed in the first two months of 2020 and was further depressed in March due to the economic impact of the social distancing measures put in place by many governments in order to contain the COVID-19 virus. One of the more high-profile examples of the effects of COVID-19 on deal making was the withdrawal by Xerox Holdings Corporation ("Xerox") of its $35 billion tender offer to acquire HP Inc. ("HP"), where Xerox cited the current "global health crises and resulting macroeconomic and market turmoil caused by COVID-19" as having created an environment not conducive to its pursuit. Only eight megadeals (>$10 billion) were announced in Q1 2020, down from 11 in Q1 2019 and 14 in Q1 2018. The most recent, the pending $35.6 billion merger between Willis Towers Watson Public Limited Company and Aon plc, was announced on March 9, 2020, the same day the government of Italy announced nationwide quarantine measures.

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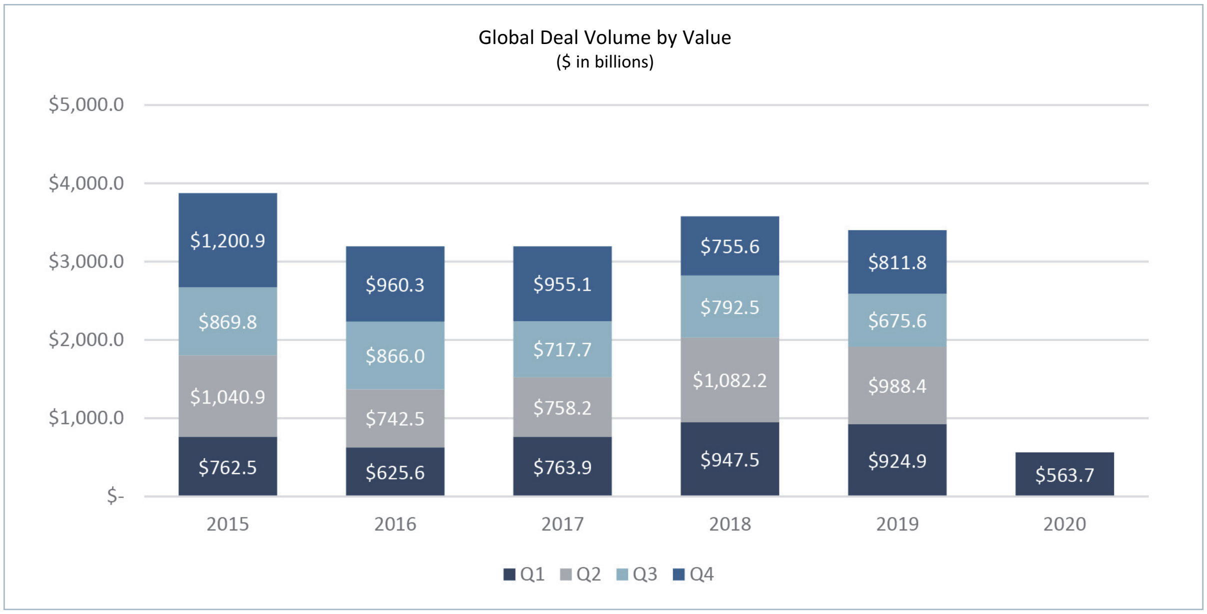
[1] All data regarding M&A activity from Mergermarket unless otherwise indicated. Deal values and volume may vary across our newsletters due to continuous updates to the M&A activity sources.

[2] A summary of certain of those transactions can be found on page 7.



Source: Mergermarket

Cross-Border Deals Declined Substantially Relative to Q1 2019

Continuing the 2019 trend of declining cross-border M&A activity and in line with the decrease in global deal making activity, Q1 2020 cross-border deals declined ~28% by value to $191.4 billion compared to Q1 2019; cross-border deals accounted for ~34% of global M&A activity by value in the quarter. European outbound M&A in Q1 2020 decreased ~40% by value compared to Q1 2019. Investors based in the Middle East & Africa region announced only 20 deals outside the region with a combined value of $2.5 billion. This represented a ~25% decrease in value compared to Q1 2019. Japanese outbound transactions totaled $8.7 billion in Q1 2020, ~59% less than the average quarterly outbound deal value from Japan for the last ten years. An even more drastic decrease was seen in Chinese investments in Europe during Q1 2020, with only 12 deals totaling $1.4 billion, compared to the highs of Q1 2016 when almost $50 billion was spent (including China National Chemical Corporation's takeover of Syngenta AG).

Private Equity To Face Challenges; Europe Remains Strong as PE Activity Declines in Other Regions

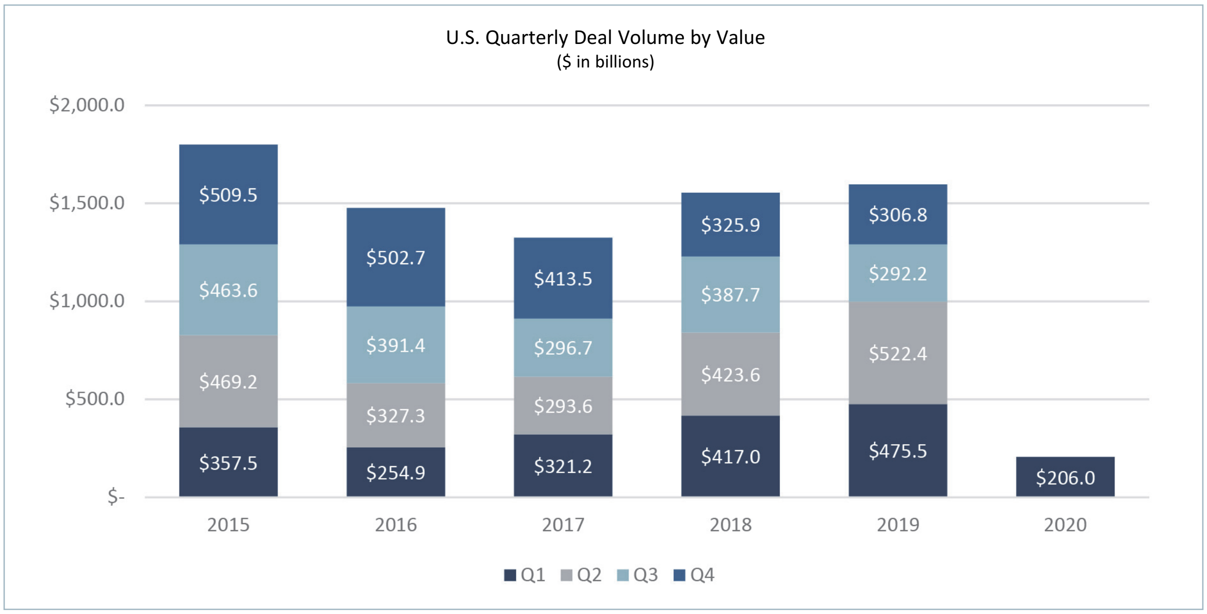
Due to a strong start to the year, private equity deal value remained at a similar level in Q1 2020 ($120.5 billion) compared to Q1 2019 ($120.4 billion) despite the recent global slowdown, though deal count decreased from 875 transactions in Q1 2019 to 692 in Q1 2020. As the primary market for leveraged loans temporarily shut down, private equity's ability to deploy capital was restricted in Q1 2020, with the number of buyouts plummeting in March. Although financial sponsors have record amounts of dry powder, valuations saw downward pressure in Q1 2020, with the median EBITDA buyout multiple for private equity deals in Q1 2020 declining to 11.1x from 12.1x in FY 2019.

On a regional basis, Europe enjoyed strong buyout activity in Q1 2020, totaling $56.8 billion across 258 deals, a ~73% increase in value in relation to Q1 2019 and accounting for ~29% of European M&A activity, though only $6.4 billion in buyouts were announced in March. In the United States, leveraged buyout activity decreased from $54.7 billion in Q1 2019 to $43.6 billion in Q1 2020, with private equity exits down ~44% by value to $48.8 billion in Q1 2020 from $86.4 billion in Q1 2019. In Latin America, buyout activity experienced its slowest quarter since 2013, dropping ~82% by value from $1 billion in Q1 2019 to $197 million in Q1 2020.
In the Asia Pacific region excluding Japan, buyout activity dropped, experiencing a ~54% year-on-year decrease in deal value to $9.4 billion, with exits generating just $4.8 billion in comparison to $17.3 billion in Q1 2019. Japan fared moderately better, recording $2.3 billion worth of buyouts in Q1 2020, which still represented a ~23% value decrease compared to Q1 2019.

U.S. M&A Market Continues Slowdown

The overall decline in the U.S. M&A market, which started in the second half of 2019 likely due to political and economic uncertainty, continued in the new year and accelerated due to the COVID-19 pandemic. Q1 2020 featured $206 billion worth of deals across 1,255 transactions, a ~57% decrease by value relative to Q1 2019. As a result, the U.S. market only accounted for ~36% of global M&A, down from ~51% in Q1 2019.

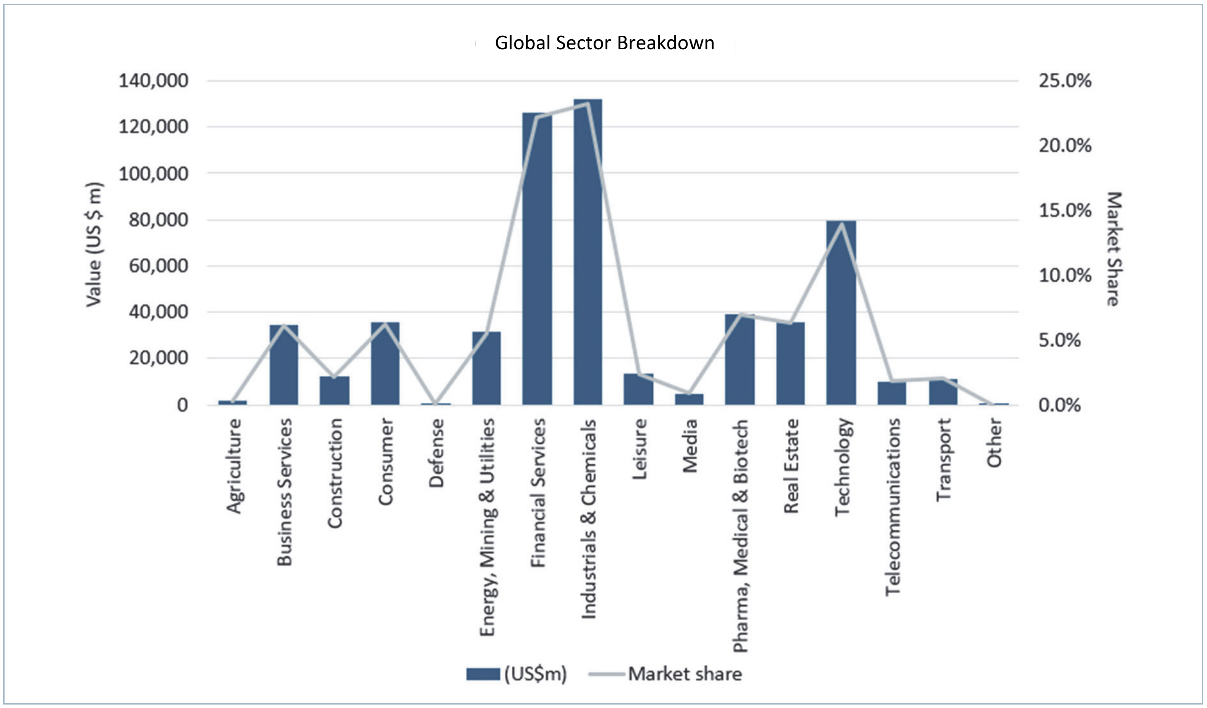
Megadeals, which drove M&A activity in 2019, played less of a role in Q1 2020, with only three megadeals worth a total of $40.1 billion announced in Q1 2020 compared to eight such deals worth a total of $287 billion in Q1 2019. There were fewer small and mid-market deals as well, with 367 deals worth $78.4 billion in Q1 2020, a ~20% decrease compared to Q1 2019 (536 deals worth $102 billion). Average deal size where the value was disclosed was $515 million in the United States in Q1 2020, relative to an average deal size of $845 million for disclosed deals in Q1 2019.



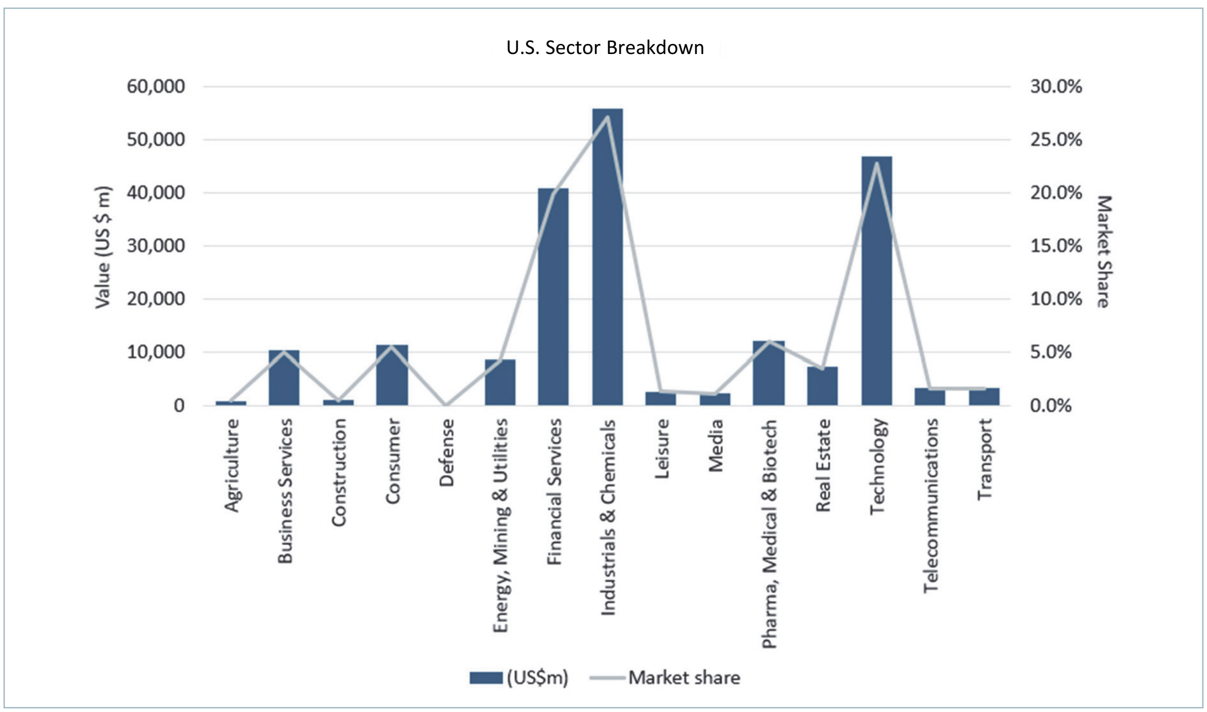
Source: Mergermarket

Major Activity in Certain Sectors

In terms of global deal value, the Industrials & Chemicals sector led the way in Q1 2020, posting ~$130 billion worth of deals, accounting for ~23% of global deal value and including two of the five largest deals so far this year—Advent, Cinven and RAG-Stiftung's $18.8 billion acquisition of ThyssenKrupp's elevator business and United Technologies Corporation's $17.3 billion spinoff of OTIS—as well as another megadeal in United Technologies Corporation's $10.4 billion spinoff of Carrier Global Corporation. The Financial Services sector was a close second, featuring ~$125 billion worth of deals and accounting for ~22% of global deal value in Q1 2020, of which Aon's $35.6 billion merger with Willis Towers Watson was the largest deal of the quarter. Technology, Pharma, Medical & Biotech and Real Estate were the three other most active sectors, featuring ~$80 billion, ~$40 billion and ~$35 billion worth of deals, respectively. While the Pharma, Medical & Biotech sector remained active as compared to other sectors, activity within the sector saw a sharp decline in Q1 2020, falling from ~$180 billion in Q1 2019 to ~$40 billion in deals in Q1 2020.



Source: Mergermarket



Source: Mergermarket

LEGAL DEVELOPMENTS

Cases

Q1 2020 featured a number of notable cases in the M&A space.

***In Re Essendant, Inc. Stockholder Litigation*, C.A. 2018-0789-JRS (Del. Ch. December 30, 2019)**

In this case, the Delaware Court of Chancery granted a motion to dismiss claims against Sycamore Partners ("Sycamore"), a private equity firm that owned approximately 11% of the outstanding shares of Essendant, Inc. ("Essendant"), in connection with Sycamore's acquisition of Essendant, holding that the plaintiff stockholders failed to show that Sycamore was a controlling stockholder of Essendant. In doing so, the Court reaffirmed that a minority stockholder must have "exercise[d] such formidable voting and managerial power that, as a practical matter, it [was] no differently situated than if it had majority voting control" in order to be considered a controlling stockholder. Specifically, the Court noted that "Sycamore did not (i) nominate members of the Essendant Board, (ii) wield coercive contractual rights, (iii) maintain personal relationships with any of the Essendant Board members, (iv) maintain any commercial relationships with Essendant that would afford leverage in its negotiations, (v) threaten removal, challenge or retaliate against any of the Essendant Board members or (vi) otherwise exercise 'outsize influence' in Essendant's Board room." The Court further noted that because two other entities held larger voting blocs than Sycamore, it would have been difficult for Sycamore to achieve any of these markers of control.

***Voigt v. Metcalf, et al.*, No. CV 2018-0828-JTL, 2020 WL 614999 (Del. Ch. Feb. 10, 2020)**

In this case, the Delaware Court of Chancery denied a motion to dismiss claims of breach of fiduciary duty against Clayton, Dubilier & Rice LLC ("CDR"), a private equity firm that held 34.8% of the equity in NCI Building Systems, Inc. ("NCI"), in connection with NCI's merger with a company controlled by CDR, holding that the plaintiff shareholder pleaded facts reasonably sufficient infer that CDR controlled NCI. Specifically, the Court considered (i) CDR's ability to designate four of the 12 board seats and its longstanding ties with other board members, which was supported by NCI's own public disclosures recognizing CDR's influence over certain directors, (ii) the size of CDR's equity stake, (iii) CDR's consent rights and other contractual rights under the stockholders agreement that granted "power over the Company beyond what the holder of a mathematical majority of the voting power ordinarily would possess," (iv) other sources of board-level influence, such as CDR's right to proportional representation on each committee of the board and (v) CDR's relationships with key executives and advisors of NCI. As the Court noted in this decision, "whether a constellation of facts supports an inference of control is a fact-specific inquiry, and different constellations of facts can lead to different outcomes."

***Lebanon County Employees' Retirement Fund and Teamsters Local 443 Health Services & Insurance Plan v. AmerisourceBergen Corporation*, C.A. 2019-0527-JTL (Del. Ch. January 13, 2020)**

In this case, the Delaware Court of Chancery held that the plaintiffs, stockholders of the defendant AmerisourceBergen Corporation ("AmerisourceBergen"), were entitled under Section 220 of the Delaware General Corporation Law ("DGCL") to inspect board-level documents that formally evidence the directors' deliberations and decisions relating to the AmerisourceBergen's opioid-distribution practices and authorized a deposition to explore what other types of books and records exist and who has them.

AmerisourceBergen is one of the largest distributors of opioids in the United States and, along with a number of other drug distributors and manufacturers, is currently a defendant in a multi-district litigation that consolidated lawsuits regarding opioids by state regulators and other private and public plaintiffs. In May 2019, the plaintiffs served a books and records demand on AmerisourceBergen under Section 220 of the DGCL seeking board materials relating to ten categories of information to "investigate whether the Company's Directors and Officers have committed mismanagement or breached their fiduciary duties" in connection with opioid distribution. AmerisourceBergen rejected the plaintiff's demand in its entirety, arguing that the demand "did not state a proper purpose or a credible basis to suspect wrongdoing" and that the scope of the inspection was "overly broad" and the plaintiffs filed an action in July 2019 to enforce their statutory inspection right.

Under Delaware law, in order to inspect books and records under Section 220, a plaintiff must have "a proper purpose." When a stockholder seeks to inspect books and records to investigate corporate wrongdoing, the stockholder must demonstrate "by a preponderance of the evidence, a credible basis" of such wrongdoing to establish a proper purpose. In a lengthy opinion, the Court held that the plaintiffs had shown "by a preponderance of the evidence that there is a credible basis to infer that AmerisourceBergen possibly violated the Controlled Substances Act" and that "the flood of government investigations and lawsuits relating to AmerisourceBergen's opioid-distribution practices is sufficient to establish a credible basis to suspect wrongdoing warranting further investigation." Further, the Court held that the stockholders were not required to "identify all of the potential uses for books and records before knowing what the books and records reveal."

AmerisourceBergen appealed the Court of Chancery's decision and, on March 5, 2020, the Delaware Supreme Court granted AmerisourceBergen's appeal, signaling that the Supreme Court would examine the scope of the statutory proper-purpose requirement under Section 220, the stockholder's burden to demonstrate wrongdoing when seeking books and records and the scope of the court's remedies in a Section 220 action.

Blackrock Credit Allocation Income Trust, et al. v. Saba Capital Master Fund Ltd., C.A. 2019-0416-MTZ (Del. January 13, 2020)

In this decision, the Delaware Supreme Court reversed the Court of Chancery's determination that a stockholder ("Saba") of two closed-end funds (the "Trusts") was excused from complying with the deadline set forth in the Trusts' advance notice bylaws for submitting supplemental information requested by the boards of the Trusts regarding Saba's board candidates.

On March 30, 2019, Saba delivered timely director nomination notices to the Trusts in advance of their annual meetings. The bylaws of the Trusts required nominees to provide any supplemental information "reasonably requested" by the boards of the Trusts to determine their qualifications and to do so within five business days of receipt of such request. Approximately three weeks after receiving the nomination notice, the boards requested that Saba submit additional information by completing 100-question, 47-page questionnaires for each candidate. Saba did not return the questionnaires within the five-business-day deadline and the Trusts informed Saba that its nominees would not be eligible for election due to Saba's failure to comply with the Trusts' bylaws. Prior to the annual meetings of the Trusts, Saba filed an initial complaint with the Court of Chancery requesting a preliminary injunction ordering votes for its nominees to be counted at the annual meetings. The Court of Chancery granted Saba's request, holding that although the five-business-day deadline for information requests was unambiguous and Saba was required to comply with it, the information sought by the questionnaires was not "reasonably requested" or "necessary" to determine the qualifications of the Saba nominees and therefore outside of the scope of the Trusts' bylaws and excused Saba for failing to comply with the five-business-day deadline.

On appeal, the Supreme Court affirmed in part and reversed in part. The Supreme Court agreed with the Court of Chancery's holding that the bylaws and the five-business-day deadlines were unambiguous, but held Saba had a clear obligation to respond to the request before the expiration of the deadline, which it failed to do. The Supreme Court noted that although even the Trusts conceded that some of the questions in the questionnaire were not tethered to the requirements under the bylaws, it was not acceptable for a stockholder "to simply let pass a clear and unambiguous deadline contained in an advance-notice bylaw, particularly one that had been adopted on a clear day." The Supreme Court stated that if Saba believed that the questionnaires were overly broad, it should have raised such concerns with the Trusts prior to the expiration of the deadline. The Supreme Court reasoned that "[a] rule that would permit election-contest participants to ignore a clear deadline and then, without having raised any objection, proffer after-the-fact reasons for their non-compliance with it, would create uncertainty in the electoral setting" and "potentially frustrate the purpose of advance notice bylaws."

Salzberg, et al. v. Sciabacucchi, No. 346, 2019 (Del. Mar.18, 2020)

In this decision, the Delaware Supreme Court considered the Court of Chancery's determination that federal-forum provisions ("FFPs") in charters of Delaware corporations designating the federal courts as the exclusive forum for claims brought under the Securities Act of 1933 are invalid because such claims do not involve rights or relationships that were established by or under Delaware corporate law. The Supreme Court reversed the lower court's decision.

Sitting en banc, the Supreme Court held that FFPs are facially valid and consistent with intention of Delaware corporate law to provide flexibility and wide discretion for private ordering and Delaware courts to avoid duplicative efforts among courts in resolving disputes. The Supreme Court rejected the Court of Chancery's reasoning that the charter provisions permitted under the DGCL are implicitly limited to those regulating the "internal affairs" of the corporation. Instead, the Supreme Court reasoned that the DGCL permits a charter provision regulating a category of "intra-corporate affairs" such as claims under the Securities Act of 1933 that are neither "'external' nor 'internal affairs' claims." The Supreme Court also considered the question of enforceability by other states, noting that "the most difficult aspect of this dispute is not with the facial validity of FFPs, but rather, with the 'down the road' question of whether they will be respected and enforced by our sister states."

RECENT TRANSACTIONS IMPACTED BY THE COVID-19 PANDEMIC

A number of pending transactions have been impacted by the COVID-19 pandemic. This section summarizes certain of those transactions, including highlighting some developments that have occurred in April.

- In the pending acquisition of Delphi Technologies PLC ("Delphi") by BorgWarner Inc. ("BorgWarner"), BorgWarner has asserted a material breach of the acquisition agreement because Delphi did not obtain BorgWarner's written consent prior to drawing down the full available amount under its revolving credit facility.[3] In response, Delphi noted that it took such action in order to "best position the company to weather the current market conditions" and has asserted that BorgWarner unreasonably withheld its consent.[4]

- In the pending sale by Bed Bath & Beyond Inc. ("Bed Bath") of its Personalizationmall.com business ("PMall") to 1-800-Flowers.com, Inc. ("1-800-Flowers"), 1-800-Flowers informed Bed Bath that it did not intend to close the transaction on the anticipated closing date and has requested a one-month delay to closing.[5] Notably, 1-800-Flowers did not claim that a material adverse effect (an "MAE") had occurred but cited general uncertainty surrounding the COVID-19 pandemic as the justification for the delay. In response, Bed Bath sued 1-800-Flowers in order to force 1-800-Flowers to close the transaction.

- In the pending acquisition of certain of Level 4 Yoga LLC's ("Level 4") yoga studios by CorePower Yoga LLC ("CorePower"), Level 4, a franchisee of CorePower, sued CorePower after CorePower did not close the acquisition of certain yoga studios from Level 4 as anticipated.[6] Level 4 disputed CorePower's determination that Level 4 had breached certain provisions of the acquisition agreement, including the provision to conduct the business in the ordinary course.

- In the pending acquisition of a majority interest in the Victoria's Secret business of L Brands, Inc. ("L Brands") by SP VS Buyer LP ("SP"), an affiliate of Sycamore, each of L Brands and SP have sued the other party seeking a court's determination as to whether the transaction should close.[7] SP asserted, among other things, that the business had experienced an MAE and that L Brands had breached its covenant to operate in the ordinary course of business consistent with past practice when it took certain actions in response to the COVID-19 pandemic, while L Brands contended, among other things, that the acquisition agreement allocated the risk of any adverse impacts resulting from COVID-19 pandemic to SP and that L Brands did not breach its covenant to operate in the ordinary course of business consistent with past practice because the actions it had taken in response to the COVID-19 pandemic were taken to comply with applicable law, as permitted under the acquisition agreement.

- There has also been at least one instance where two merger parties mutually agreed to terminate their transaction due to the pandemic. On April 6, 2020, Woodward, Inc. and Hexcel Corporation announced that the companies mutually agreed to terminate their previously announced agreement for an all-stock merger of equals. The companies noted that the COVID-19 pandemic has had an increasing impact on their industry and the global markets broadly and that the companies needed to focus on their respective businesses. The companies also cited the impact of the pandemic on the companies' ability to realize the benefit of the merger as a reason for the termination.

REGULATORY

Antitrust

On January 10, 2020, the U.S. Federal Trade Commission (the "FTC") and Department of Justice (the "DOJ") (the "Agencies") released draft 2020 Vertical Merger Guidelines (the "2020 Guidelines") outlining the Agencies'

[3] Press Release, *BorgWarner Issues Statement Regarding Delphi Technologies' Revolver Draw Down* (March 31, 2020); https://www.borgwarner.com/newsroom/press-releases/2020/03/31/borgwarner-issues-statement-regarding-delphi-technologies-revolver-draw-down.

[4] Press Release, *Statement from Delphi Technologies: 03/31/2020*; https://ir.delphi.com/investors/press-releases/press-release-details/2020/Statement-from-Delphi-Technologies/default.aspx.

[5] Complaint, *Bed Bath & Beyond Inc. v. 1-800-Flowers.com, Inc. and 800-Flowers, Inc.*, 2020-0245 (Del. Ch. Apr. 1, 2020).

[6] Complaint, *Level 4 Yoga, LLC v. CorePower Yoga, LLC and CorePower Yoga Franchising LLC*, 2020-0249 (Del. Ch. Apr. 2, 2020).

[7] Complaint, *SP VS Buyer LP v. L Brands Inc.*, 2020-0297 (Del. Ch. Apr. 22, 2020); Complaint, *L Brands, Inc. v. SP VS Buyer L.P., Sycamore Partners III, L.P., and Sycamore Partners III-A, L.P.*, 2020-0304 (Del Ch. April 23, 2020).

principal analytical techniques, practices and enforcement policy for vertical mergers for public comment. If accepted, the 2020 Guidelines will replace the 1984 Non-Horizontal Merger Guidelines (the "1984 Guidelines"), which were officially withdrawn concurrently with the release of the draft 2020 Guidelines.

The draft 2020 Guidelines outline the Agencies' analytical and enforcement considerations that are specific to vertical mergers, such as market definition and related products, competitive effects and efficiencies. Notably, the draft 2020 Guidelines explain that the Agencies are unlikely to challenge a vertical merger where the parties to the merger have a share in the relevant market of less than 20%, and a product or service supplied by the merged firm that is vertically related to the relevant market is used in less than 20% of the relevant market. The draft 2020 Guidelines stress that these thresholds are not to be considered a safe harbor provision nor a rigid screen. However, as a practical matter, this guidance indicates that transactions involving merging parties that have less than a 20% market share in both the relevant upstream and downstream markets will be presumed to be unlikely to raise competitive concerns.

The draft 2020 Guidelines outline both unilateral and coordinated theories of adverse competitive effects for vertical mergers. Unilateral theories of harm, which were not included in the 1984 Guidelines, include foreclosure and raising rivals' costs and gaining access to competitively sensitive information. Coordinated theories of harm include that a vertical merger may enhance the market's vulnerability to coordination, such as by elimination of a maverick firm by raising its costs. The draft 2020 Guidelines recognize efficiencies and explicitly consider the effect of the elimination of double marginalization, which can occur when the merged firm combines margins on both upstream and downstream products and is thereby able to decrease prices. The draft 2020 Guidelines note that the Agencies generally rely on the parties to identify and demonstrate whether and how the merger eliminates double marginalization, and state affirmatively that the Agencies "will not challenge a merger if the net effect of elimination of double marginalization means that the merger is unlikely to be anticompetitive in any relevant market."[8]

As a general matter, commentators view the proposed guidelines as better reflecting current analysis used by the DOJ and FTC in connection with vertical mergers. The agencies announced a 30-day comment period which was extended until February 26, 2020, and announced two public workshops to solicit public dialogue on the proposed guidelines, the second of which was canceled due to the developing COVID-19 coronavirus pandemic.

On January 28, 2020, the FTC announced the annual changes to the monetary thresholds for Hart-Scott-Rodino ("HSR") Act notifications. Based on the change in gross national product, the 2020 HSR reporting thresholds have increased by approximately 4.4% over the 2019 HSR reporting thresholds, with the size-of-transaction threshold increasing to $94 million from $90 million. These changes became effective on February 27, 2020.

CFIUS

Regulations

On January 13, 2020, the U.S. Department of the Treasury ("Treasury") issued two final regulations to implement the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") and to provide the Committee on Foreign Investment in the United States ("CFIUS") with the ability to better address national security concerns arising from certain investments and real estate transactions. The final rules became effective on February 13, 2020.

The rules finalized two proposed rules that Treasury published on September 17, 2019.[9] Although the final rules largely retained the framework of the proposed rules, the final rules included a number of important changes and clarifications, including:

- **Exemptions to mandatory filing requirement for certain critical technology investments.** The final rules incorporated the critical technology pilot program launched by CFIUS in October 2018, including a mandatory filing requirement for covered investments in certain U.S. businesses that deal with "critical technologies." The final rules, however, established significant new exceptions to the mandatory filing requirement, and indicated that further changes to such requirement are likely.

[8] Guidelines, "Draft Vertical Merger Guidelines" (January 10, 2020); https://www.justice.gov/opa/press-release/file/1233741/download.

[9] A summary of the proposed rules can be found in the Q3 2019 issue of the *Cravath Quarterly Review: M&A, Activism and Corporate Governance*.

- **Exemption from CFIUS's expanded jurisdiction for "excepted investors".** FIRRMA requires that CFIUS limit its expanded jurisdiction to certain categories of foreign persons. CFIUS has implemented this requirement by excluding investors from certain countries from its new jurisdiction. Currently, only Canada, Australia, and the United Kingdom have been granted excepted foreign state status through February 13, 2022, although CFIUS may expand the list in the future.

- **Clarification concerning investment funds and the definition of "foreign person".** The final rules included an interim definition of "principal place of business," which is one component of determining whether an entity is a "foreign person" for CFIUS purposes. The new definition is intended to provide clarity concerning investment funds organized outside the United States but managed and controlled by U.S. persons.

On March 9, 2020, Treasury issued a proposed rule that would establish filing fees for transactions notified to CFIUS through a written notice (*i.e.*, a long-form filing). The proposed rule includes a tiered fee structure for transactions valued at $500,000 or more, ranging from $750 to $300,000 based on the transaction's value. Under the proposed rule, CFIUS would not accept a transaction for review until the filing fee is paid, except in certain limited circumstances. No fee would be required for transactions notified to CFIUS through a declaration (*i.e.*, a short-form filing). The comment period on the proposed rule closed on April 8, 2020, and Treasury has not yet issued a final rule.

In late March, Treasury made available on its website a geographic reference tool developed to assist the public in understanding certain aspects of CFIUS's new jurisdiction over real estate transactions. According to Treasury, the tool is for general reference only and should not be interpreted as guidance or an advisory opinion by CFIUS.

Enforcement

On March 6, 2020, President Donald J. Trump issued an Executive Order prohibiting the acquisition of StayNTouch, Inc. ("StayNTouch"), a Delaware corporation that provides cloud-based property management system software to hotels, by Beijing Shiji Information Technology Co., Ltd. ("Shiji"), a public company organized under the laws of China that provides solutions for the hospitality, food service, retail and entertainment industries. The Order, which came 18 months after Shiji acquired StayNTouch, required that Shiji divest StayNTouch within 120 days, and prohibited Shiji from accessing hotel guest data through StayNTouch until the divestment is completed. This was the sixth presidential prohibition in the history of CFIUS and another indication of CFIUS's increased activity, particularly with respect to transactions that have already closed and transactions involving sensitive personal data.

Activism[10]

In April 2020, Lazard released its Q1 2020 *Review of Shareholder Activism*, which offers key observations regarding activist activity levels and shareholder engagement in the first quarter of 2020.

Key findings / insights from the report include:

- number of campaign initiations in Q1 2020 was in line with Q1 2019, but lagged historical averages;
- strong start in January and February in global activism activity, but significant slowdown in March;
- European activists accounted for an increasing number of campaign initiations in Europe (~71% in Q1 2020 compared to ~58% in FY 2019);
- ten campaigns settled in March, while several activists have withdrawn or postponed campaigns, citing market conditions; and
- activists will likely face additional hurdles after the COVID-19 pandemic (due to increased poison pill activity and/or government equity stakes), but activity will likely pick up meaningfully after the pandemic.

TRENDS

Campaign Activity in Line with 2019 But Lagged Historical Averages

There were 58 new campaigns initiated at 58 companies in Q1 2020, which was in line with Q1 2019 (57 campaigns initiated at 53 companies), but down generally from the three prior years (65 campaigns initiated at 61 companies in Q1 2016, 70 campaigns initiated at 64 companies in Q1 2017 and 69 campaigns initiated at 67 companies in Q1 2018). Capital deployment in Q1 2020 increased ~23% to $14.4 billion from $11.7 billion in Q1 2019, but was down from the $25.3 billion deployed in Q1 2018 and $16.5 billion deployed in Q1 2017. The bulk of global activism activity happened in January and February, with 42 campaigns initiated during that time, deploying $13.1 billion in capital.

In Q1 2020, there were 43 board seats won through settlements and zero won through proxy fights; generally in line with the 39 won in Q1 2019. Out of the 43 board seats won in Q1 2020, ~33% (14 seats) were filled with activist fund employees. As of March 31, 2020, there were 72 board seats "in play" at upcoming shareholder meetings where there were announced proxy contests.

European Activism Started Strong Before Slowing Substantially in March

Q1 2020 saw a historic number of campaigns initiated in Europe—21 new campaigns were initiated, ~50% greater than the Q1 average of 14 new campaigns initiated from 2016-2019. In March, campaign initiations dropped, as only five campaigns were initiated compared with 11 in February. Activists deployed $6.5 billion in European companies in Q1 2020, which exceeded Q1 2019 figures and amounted to ~70% of the 2019 yearly total of $9.2 billion. Local activists have increasingly initiated campaigns, accounting for ~71% of campaigns launched in Q1 2020 compared to ~58% of campaigns launched in all of 2019. However, in terms of capital deployed, U.S. activists continued to lead, deploying $5.5 billion in new campaigns in Europe.

COVID-19 Changed the Activism Landscape

The market dislocation due to the COVID-19 public health crisis impacted ongoing activist campaigns, with some activists taking advantage of market conditions by ratcheting up pressure and/or increasing positions, while others opted to settle or withdraw campaigns amid the ongoing market volatility. Ten campaigns settled in March, with several other campaigns withdrawing citing "market conditions." With M&A activity decreasing to multi-year lows in March, only five of the 16 campaigns initiated in March had an M&A thesis. Similarly, given the corporate focus on preserving liquidity and government polices opposing the return of capital, activists have decreased focus on capital returns (*i.e.*, dividends or buybacks) as a primary campaign objective, with only one campaign initiated in Q1 2020 having a capital return thesis.

Due to market conditions, companies implemented shareholder rights plans (poison pills) at a rate not seen since the financial crisis, when 50 poison pills were implemented in 2009. In Q1 2020, 28 poison pills were implemented compared to 8 in Q1 2019, with 22 implemented in March. The vast majority of poison pills were implemented by small- and micro-cap companies, with the median market capitalization of companies enacting poison pills being $0.2 billion and only three companies with market capitalizations greater than $2 billion implementing poison pills.

[10] Activism data from Lazard, *Review of Shareholder Activism – Q1 2020*, which includes all data for campaigns conducted globally by activists at companies with market capitalizations greater than $500 million at the time of campaign announcement; companies that are spun off as part of the campaign process are counted separately.

SELECT CAMPAIGNS / DEVELOPMENTS

Company	Market Capitalization ($ in billions)[11]	Activist	Outcome
eBay	$31.7	Starboard	• In February 2020, Starboard sent a letter to eBay expressing concerns with eBay's lack of progress with respect to the cooperation agreement entered into in March 2019 • In March 2020, Starboard nominated four individuals for board election at the 2020 annual meeting and pushed incumbent directors to focus on their CEO search; eBay noted that Starboard's stake at that time was approximately 1% • In April 2020, Starboard withdrew its nominees following the appointment of a new CEO; eBay also said it expected to name a new independent director in the next few months and will consider the individuals Starboard nominated
SoftBank	$89.8	Elliott	• In February 2020, news media reported that Elliott had built up a $2.5 billion (approximately 3%) stake in Softbank and urged SoftBank to make certain changes to improve share price, including by implementing a $10-$20 billion share buyback program • In March 2020, SoftBank announced a $4.8 billion share buyback program and Elliott announced its support for the program; SoftBank later announced an additional $18 billion in share buybacks funded by a $41 billion asset sale plan
Twitter	$25.8	Elliott	• In February 2020, news media reported that Elliott had built up a $1 billion (approximately 4%) stake in Twitter and planned to seek certain changes at Twitter, including to replace CEO Jack Dorsey, and nominated four individuals for board election • In March 2020, Twitter and Elliott reached a settlement where, among other things, Twitter agreed to appoint an Elliott executive, a Silver Lake executive (following a Silver Lake $1 billion investment) and a third independent director to its board; the agreement did not include removal of CEO Jack Dorsey
Prudential plc	$47.8	Third Point	• In February 2020, Third Point sent a letter to Prudential disclosing a stake of just under 5% and urging the Prudential board to consider, among other things, the separation of Prudential's Asia and U.S. operations; Prudential responded that it plans to engage with Third Point
Avis Budget Group	$2.8	SRS Investment Management	• In 2016, 2017 and 2018, Avis and SRS entered into several agreements to settle proxy contests • In January 2020, concurrent with the expiration of the standstill provisions in the 2018 agreement, Avis announced that it adopted a rights plan intended to prevent SRS from gaining effective control of Avis without paying a control premium and noted that it had made good-faith attempts to reach a new agreement with SRS but had been unable to do so • In February 2020, Avis and SRS reached a new agreement where, among other things, Avis agreed to appoint three SRS designees to its board; SRS had an approximately 21.8% stake in Avis at the time of the agreement
Tegna	$3.6	Standard General	• In January 2020, Standard General issued a letter to shareholders disclosing it would nominate four individuals for board election at the 2020 annual meeting; Standard General had an approximately 9.7% stake in Tegna at the time it nominated the four individuals
Kirin Holdings Co.	$19.2	Independent Franchise Partners	• In November 2019, Independent Franchise Partners launched a campaign urging Kirin to reverse its diversification strategy; Independent Franchise Partners' stake in Kirin was reported to be approximately 2% • In March 2020, shareholders voted down Independent Franchise Partners' proposal that Kirin divest the company's non-core holdings and use the proceeds to carry out a share buyback
Box, Inc.	$2.2	Starboard	• In September 2019, Starboard announced that it had acquired an approximately 7.5% stake in Box but did not disclose any further intentions • In March 2020, Box and Starboard reached an agreement where, among other things, Box agreed to appoint three Starboard designees to its board
Gamestop Corp.	$0.3	Hestia and Permit	• In March 2020, an investor group consisting of Hestia and Permit sent a letter to Gamestop urging it to appoint a stockholder representative as a director following the end of a 2019 cooperation agreement (pursuant to which the investor group agreed to refrain from publicly expressing concerns); the investor group's stake in Gamestop was approximately 7.5% at the time of the letter • In April 2020, Gamestop and the investor group reached a settlement where, among other things, Gamestop agreed to appoint a designee of the investor group and an additional independent director to its board.

[11] Market capitalization as of campaign announcement.

Corporate Governance

TRENDS

2020 Proxy Season

Two recent surveys of institutional investors conducted by the EY Center for Board Matters (the "EY Survey")[12] and Morrow Sodali (the "Morrow Sodali Survey")[13] suggest the following as major areas of corporate governance focus in 2020: (1) environmental, social and governance ("ESG") issues, (2) board diversity, (3) executive compensation and (4) human capital management.

ESG Issues

In the Morrow Sodali Survey, 100% of the respondents answered that ESG risks and opportunities played a greater role in their investment decisions during the last 12 months, with climate change being at the top of their list of topics with the most significant impact (~86%). In the EY Survey, ~56% of the investors responded that effective management of ESG issues will be critical to the strategic success of their portfolio companies in the next three to five years, with ~59% of the respondents indicating ESG issues as a top investor engagement priority for 2020.

ESG issues have also been at the forefront of annual communications from large institutional investors:

- In January 2020, BlackRock's CEO Larry Fink published his annual letter stating that "climate risk is investment risk."[14] He noted that companies and investors have a "meaningful role" to play in the transition to a low-carbon world and that "[e]very government, company and shareholder must confront climate change." In a related letter from BlackRock to its clients, entitled "Sustainability as BlackRock's New Standard for Investing," BlackRock detailed several initiatives aimed at furthering its integration of sustainability into its active and passive investing offerings.[15] BlackRock further underscored its commitment to sustainability in its Investment Stewardship Engagement Priorities for 2020 report (the "BlackRock Report")[16], published in March 2020, noting that "the Priorities also further BlackRock's commitment in January to make sustainability its new standard for investing."
- State Street Global Advisors President and CEO Cyrus Taraporevala sent a letter, in January 2020, to board members emphasizing its focus on sustainability and stating that it would use its proxy vote "to press companies that are falling behind and failing to engage."[17] He noted that beginning this proxy season, State Street will take appropriate voting action against board members at companies in certain indices which are ESG "laggards" based on their R-Factor (a metric introduced by State Street last year that measures the performance of a company as it relates to financially material and sector-specific ESG issues). The letter also attached a framework for helping board members prioritize ESG within their companies and take appropriate action.

Institutional Shareholder Services Inc. ("ISS") has also increased its focus on ESG issues. In response to demand to address climate change-related concerns through voting, ISS published Climate Voting Guidelines in March 2020.[18] The Climate Voting Guidelines include, among other recommendations, a recommendation to vote against or withhold from directors individually or relevant responsible committee members due to a failure to adequately address climate-related risks, realize climate-related opportunities and improve climate-related performance.

Board Diversity

In the EY Survey, ~54% of surveyed investors indicated board diversity as a top investor engagement priority for 2020. The BlackRock Report stated BlackRock's view that "diverse boards make better decisions." It also noted that BlackRock may vote against members on the governance and/or nominating committees

[12] EY Center for Board Matters, *2020 Proxy Season Preview* (January 2020); https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/cbm-2020-proxy-season-preview.pdf.

[13] Morrow Sodali, *Institutional Investor Survey 2020* (March 2020); https://morrowsodali.com/uploads/insights/attachments/83713c2789adc52b596dda1ae1a79fc2.pdf.

[14] Larry Fink, *A Fundamental Reshaping of Finance*; https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[15] BlackRock, *Sustainability as BlackRock's New Standard for Investing*; https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter.

[16] BlackRock, *BlackRock Investment Stewardship Engagement Priorities for 2020* (March 2020); https://www.blackrock.com/corporate/literature/publication/blk-stewardship-priorities-final.pdf.

[17] Cyrus Taraporevala, *CEO's Letter on our 2020 Proxy Voting Agenda* (January 28, 2020); at https://www.ssga.com/us/en/individual/etfs/insights/informing-better-decisions-with-esg.

[18] Press Release, *United States Climate Proxy Voting Guidelines* (March 9, 2020); https://www.issgovernance.com/file/policy/active/specialty/Climate-US-Voting-Guidelines.pdf.

where boards are insufficiently diverse. Similarly, there is focus at state and municipal pension funds on diversity among corporate leadership. For example, the New York City Comptroller's office recently announced the "successful" results from its Boardroom Accountability 3.0 project which was launched in October 2019 and called on "companies to adopt a policy requiring the consideration of both women and people of color for director and CEO searches."[19]

In addition to the focus by institutional investors, gender diversity in the boardroom has also garnered the attention of state legislatures:

- In March 2020, the California Secretary of State published its annual report related to Senate Bill 826, passed in 2018, a gender diversity law requiring publicly held corporations with a principal executive office in California to have a minimum number of female directors on their boards of directors.[20] The law requires each corporation subject to the law to state on its Publicly Traded Corporate Disclosure Statement (a filing made with the California Secretary of State within 150 days of the corporation's fiscal year end) whether the corporation complies with the law. At the time of the California Secretary of State's report, out of the 625 corporations subject to the law, 330 had filed their 2019 Publicly Traded Corporate Disclosure Statements. Of those 330 corporations, 282 reported compliance with the law.

- On December 31, 2019, New York enacted the "Women on Corporate Board Study Act" which requires the New York Department of State and Department of Taxation and Finance to conduct a study on the number of women directors who serve on each board of directors of domestic and foreign corporations authorized to do business in New York.[21] Corporations must provide this information on their biennial filings with the New York Secretary of State as required under Section 408 of the Business Corporation Law. The law will take effect on June 27, 2020.

Executive Compensation

Both the EY Survey and the Morrow Sodali Survey indicated that executive compensation continues to be a strong area of focus for institutional investors. 100% of respondents in the Morrow Sodali Survey indicated that misalignment of pay and performance is the primary factor to consider voting against executive compensation. ~66% of respondents in the EY Survey cited a disconnect between pay and long-term value drivers as a consistent concern. Respondents were also concerned with the complexity of compensation plans, insufficient responsiveness to shareholder concerns and outsized or ballooning compensation packages. The BlackRock Report noted that BlackRock expects a meaningful portion of executive compensation to be tied to the company's long-term returns rather than short-term increases in share price. The BlackRock Report also stated that companies should explain and justify metrics used to trigger payments under incentive plans, including a clear articulation of the company's balance between using metrics that are within management's control and metrics that are not. In addition, the BlackRock Report noted that BlackRock may vote against compensation committee members in certain instances, including where a company has not demonstrated the connection between strategy, long-term shareholder value creation and incentive plan design.

Human Capital Management

The EY Survey reported that ~64% of their respondents found that talent management is critical to strategic success in the next three to five years, with a large percentage of those focusing on workforce compensation and diversity. In the Morrow Sodali survey, ~64% of respondents indicated human capital management as one of top three sustainability topics on which they will focus when engaging with boards in 2020. Investor respondents in both surveys noted corporate culture and board oversight, including "tone at the top," as being areas on which they determine if a company's human capital management achieves long-term value. A similar view is noted in the BlackRock Report. BlackRock noted that it expects disclosure with respect to a company's approach to human capital management to provide investors with an understanding of how boards oversee and work with management to adopt sound business practices likely to create an engaged and stable workforce.

[19] Press Release, *NYC Comptroller Stringer and Retirement Systems Announce Precedent-Setting Board/CEO Diversity Search Policies as part of Boardroom 3.0 Initiative* (April 14, 2020); https://comptroller.nyc.gov/newsroom/nyc-comptroller-stringer-and-retirement-systems-announce-precedent-setting-board-ceo-diversity-search-policies-as-part-of-boardroom-3-0-initiative.

[20] Alex Padilla, Secretary of State Office, *Women on Boards* (March 2020); https://bpd.cdn.sos.ca.gov/women-on-boards/WOB-Report-04.pdf.

[21] S. 4278, 2019-2020 Legis. Sess. (N.Y. 2019).

POLICY

SEC Proxy Advisor Guidance Litigation Stayed

On January 17, 2020, ISS and the SEC agreed to stay the litigation related to the SEC's August 2019 proxy advisor guidance until the earlier of January 1, 2021 or the promulgation of final rules in the SEC's proxy advisor rulemaking.[22] ISS had sued the SEC in October 2019 seeking to invalidate the SEC's August 2019 guidance that articulated the SEC's view that proxy voting advice generally constitutes a solicitation subject to the federal proxy rules. The SEC confirmed that it would not enforce the interpretation and guidance during the stay. Meanwhile, it remains unclear if the SEC will adopt final rules in this area prior to the upcoming presidential election.

[22] Unopposed Mot. to Hold Case in Abeyance, Institutional Shareholder Services Inc. v. Securities and Exchange Commission and Walter Clayton III in his official capacity as Chairman of the Securities and Exchange Commission, No. 1:19-cv3275-APM (D.D.C. 2019).