The Mergers & Acquisitions Review

Tenth Edition

Editor
Mark Zerdin

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Chapter 58

UNITED STATES

Richard Hall and Mark Greene[1]

I OVERVIEW OF M&A ACTIVITY

Calendar year 2015 was the strongest year for M&A activity globally, and in the United States and Asia-Pacific (excluding Japan), since Thomson Reuters began keeping records in 1980.[2] Total 2015 global M&A activity by dollar volume increased by 42 per cent over 2014 to $4.7 trillion, fuelled by 71 deals valued over $10 billion, representing a triple-digit percentage increase in the number of such deals from 2014.[3] Total 2015 US M&A activity[4] by dollar volume increased by 64 per cent over 2014 levels.[5] The US drove global M&A activity, with 4,786 deals worth $1.97 trillion, accounting for 46.2 per cent of global M&A activity, the highest share since 2001.[6] US outbound M&A reached the highest value on record and was up 38.2 per cent from 2014 levels, with deals targeting the pharmaceutical, medical and biotechnology sector strongly contributing to this increase.[7] Ireland and the UK were the most targeted countries by US companies in 2015 due to attractive tax laws.[8]

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 Nikki Ann Olson, Jesse Weiss, Sarah Colangelo and Lingfeng Li.

2 Mergers & Acquisitions Review, Full Year 2015, Financial Advisors, Thomson Reuters (2015), share.thomsonreuters.com/general/PR/MA-4Q15-(E).pdf.

3 Id.

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

5 Mergers & Acquisitions Review, Full Year 2015, Financial Advisors, footnote 2.

6 'Global and Regional M&A: 2015', Mergermarket, January 2016, www.mergermarket.com.

7 Id.

8 Id.

Announced US targeted M&A[9] reached $2.3 trillion in dollar volume, up 64.3 per cent from 2014.[10] M&A activity in the US and globally was led by the healthcare, high technology, and energy and power sectors, accounting for 23.8 per cent market share, 16.5 per cent market share and 11.4 per cent market share in the US, respectively.[11]

The upswing in US M&A activity in 2015 resulted from a spike in mega-deals. The 64.3 per cent increase in announced US targeted M&A by dollar volume was accompanied by a deal count decrease from 10,129 in 2014 to 9,962 in 2015.[12] Within US public M&A, the number of deals over $5 billion increased 38.2 per cent from 2014 to 47 signed deals, and the number of deals over $100 million increased by 25.8 per cent from 2014 to 190 signed deals.[13] The 47 signed deals over $5 billion represented 24.7 per cent of overall US targeted M&A activity, a slight increase from the 22.5 per cent share in 2014 and a significant increase from the 10 per cent share in 2013.[14] Although the percentage of leveraged public US M&A decreased slightly from 47 per cent in 2014 to 45.3 per cent in 2015, debt financing played a role in 32 of the 47 US public M&A mega-deals valued over $5 billion.[15]

US public M&A in 2015 was dominated by strategic, rather than financial, acquirers, which was also the case in 2014.[16] The dominance of strategic buyers in 2015 was most pronounced in the largest mega-deals: 43 of the 47 signed deals over $5 billion involved strategic buyers.[17] On the other hand, financial buyers accounted for only 27 of the 190 signed deals over $100 million.[18] Strategic acquirers continued to use their own highly valued stock to buy competitors, as they did in 2014, continuing to take advantage of relatively stable stock market conditions in 2015.[19] In 2015, 48.4 per cent of the 190 signed deals over $100 million included stock as part or all of the consideration, virtually no change from the 48.3 per cent of deals signed in 2014 that included stock as part of the consideration.[20] All of the top 10 US targeted announced deals in 2015 involved stock as part of the consideration.[21]

The regulatory concerns raised in 2014 in connection with mega-deals continued into 2015, with the termination of three signed deals to avoid litigation against the antitrust agencies and the abandonment of two other deals after litigation commenced. The announced acquisition of Time Warner Cable Inc by Comcast Corp, with a deal value of $70.7 billion, and the announced merger of Applied Materials Inc of the US and Tokyo Electron Ltd of Japan, with a deal value of $29 billion, were both terminated in late April 2015 under pressure

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

10 Mergers & Acquisitions Review, Full Year 2015, Financial Advisors, footnote 2.

11 Mergers & Acquisitions Review, Full Year 2015, Financial Advisors, footnote 2.

12 Practical Law Company, 'What's Market: 2015 Year-End Public M&A Wrap-up', 28 January 2016, us.practicallaw.com/w-001-3603.

13 Id.

14 Id.

15 Id.

16 Id.

17 Id.

18 Id.

19 Id.

20 Id.

21 Id.

from antitrust regulators.[22] Thai Union Group also terminated its announced $1.5 billion acquisition of US rival Bumble Bee Seafoods in December 2015 as US antitrust clearance became increasingly unlikely.[23] In February 2015, the Federal Trade Commission (FTC) filed a lawsuit challenging Sysco Corp's $3.5 billion planned acquisition of US Foods Inc (US Foods), and in June 2015, US District Judge Amit Mehta in Washington issued a preliminary injunction to stop the deal, after which Sysco Corp abandoned the deal.[24] Finally, in the summer of 2015, the US Justice Department filed a lawsuit to block the $3.3 billion sale of General Electric Co's appliances business to Electrolux AB of Sweden (Electrolux), and after 15 months of talks, General Electric Co abandoned the deal and requested payment from Electrolux of the $175 million breakup fee in December 2015 prior to the rendering of any court verdict in the trial that began in early November 2015.[25] Reflecting the increased regulatory risk associated with mega-deals, 25 of the 190 US public M&A signed deals over $100 million included reverse break-up fees payable by the buyer in the event regulatory approval was not obtained, and an additional six US public M&A deals valued between $1 billion and $5 billion also contained reverse break-up fees.

While the fourth quarter of 2015 was the largest quarter for global M&A activity since Thomson Reuters began record keeping in 1980, US targeted M&A activity by dollar volume in the first quarter of 2016 decreased by 57 per cent over the fourth quarter of 2015 and 38.2 per cent year over year.[26] US targeted withdrawn M&A deals by dollar volume was $378.2 billion as of 4 May 2016, an increase of 64 per cent from the volume of US targeted withdrawn deals for the full year in 2015 and already the largest annual volume on record, according to Dealogic.[27] The slowdown in US M&A activity in the first quarter of 2016 may be a reflection of extremely volatile equity markets, due to an aging bull market, low oil prices, a slowdown in the Chinese economy and challenging debt markets, particularly the high-yield market.[28] However, deal completion volumes traditionally decrease in the first

22 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; Brent Kendall & Don Clark, 'Applied Materials, Tokyo Electron Cancel Merger Plan', *Wall Street Journal*, 27 April 2015, www.wsj.com/articles/applied-materials-tokyo-electron-scrap-merger-plan-1430117758.

23 'What's Market: 2015 Public M&A Wrap-up', footnote 12; Reuters, 'Thai Union Group scraps $1.5 bln plan to buy Bumble Bee', 4 December 2015, www.cnbc.com/2015/12/04/chicken-of-the-sea-and-bumble-bee-foods-ditch-merger-on-doj-concerns.html.

24 'What's Market: 2015 Public M&A Wrap-up', footnote 12; Annie Gasparro, 'Sysco Ends Plans to Merge With US Foods', *Wall Street Journal*, 30 June 2015, www.wsj.com/articles/sysco-walks-away-from-us-foods-merger-1435580019.

25 'What's Market: 2015 Public M&A Wrap-up', footnote 12; Ted Mann & Jens Hansegard, 'GE Terminates Sale of Appliances Business to Electrolux', *Wall Street Journal*, 7 December 2015, www.wsj.com/articles/ge-terminates-sale-of-appliance-business-to-electrolux-1449474391.

26 Leslie Picker, 'Despite Wall St. Wavering, Merger Market Is Largely Intact', *New York Times*, 31 March 2016, www.nytimes.com/2016/04/01/business/dealbook/despite-wall-st-wavering-merger-market-is-largely-intact.html?_r=1.

27 Stockley, 'US Withdrawn M&A Volume at Record Annual High'.

28 'Insights, Q1 2016', Allen & Overy, www.allenovery.com/mainsights.

quarter of the year, and the first two quarters of each of the past two US presidential election years also saw M&A underperformance in the US.[29] It remains to be seen how M&A activity, globally and in the US, will progress for the remainder of 2016.

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 (SEC) 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 (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 $78.2 million (adjusted annually for inflation); the requirement was increased from $76.3 million in 2015.[30]

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, 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.[31] The 1992 Byrd Amendment also requires the CFIUS to conduct a full Exon-Florio investigation whenever the CFIUS receives notice of a foreign government-led takeover of a US business that may affect national security.[32]

29 'M&A: pause for breath or plateau?', Willis Towers Watson, www.willistowerswatson.com/en/press/2016/03/M-and-A-pause-for-breath-or-plateau.

30 'FTC Announces New Clayton Act Monetary Thresholds for 2016', Federal Trade Commission, www.ftc.gov/news-events/press-releases/2016/01/ftc-announces-new-clayton-act-monetary-thresholds-2016.

31 50 USC Section 4565.

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

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.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

Fair value in appraisal actions

In the wake of the Dole Food Company, Inc 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.[33] 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.[34] Delaware's statutory interest rate is generally the Federal Reserve discount rate plus 5 per cent and is higher than any rate available in the market.[35] 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 keep rising. Appraisal arbitrage claims were valued at $1.5 billion in 2013, an eightfold increase from 2012.[36] 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.[37] Approximately 81 per cent of Delaware appraisals that went to trial since 1993 obtained higher prices.[38]

A recent Delaware Court of Chancery decision failed to ensure these appraisal arbitrage claims only protect the minority of shareholders who did not favour a deal when it found that there was no requirement that the claimant show the specific shares of which it seeks appraisal voted against the deal.[39] The claimant must instead only show that more shares were voted against the merger than the number of shares of which it seeks appraisal, leaving open the door for use of the practice by hedge funds.[40]

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

34 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.

35 Id.

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

37 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.

38 Id.

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

40 Id.

Amendments have once again been proposed in 2016 by the Corporate Council of the Corporation Law Section of the Delaware State Bar Association, which committee customarily recommends legislative action to Delaware's state lawmaking body, to curb the amounts involved in appraisal arbitrage.[41] The first amendment to Section 262 of the DGCL would impose a *de minimis* exception, allowing only claims where more than 1 per cent of the outstanding shares entitled to appraisal perfect their appraisal rights or 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. These amendments have not yet taken effect, and they still fail 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.

Nevertheless, in several 2015 decisions, the Delaware Court of Chancery has relied entirely upon, or given substantial weight to, the merger price in determining fair value in shareholder appraisal actions where there was a robust, conflicts-free sales process. In *Merlin Partners LP v. AutoInfo, Inc*, the Delaware Court of Chancery determined there were no reliable cash flow projections from which to conduct a discounted cash flow (DCF) analysis, since the projections available were a first attempt and were specifically prepared to 'paint the most optimistic and bright current and future condition of the company' as possible for the purposes of a sale, whereas the merger price resulted from a competitive and fair auction process because AutoInfo, Inc:

- *a* retained an investment bank experienced in the transportation industry for an incentive-based fee;
- *b* contacted numerous companies during the sales process;
- *c* formed a special committee;
- *d* was sold at a premium to the market; and
- *e* had no other topping bids emerge between the announcement and closing of the sale.[42]

In *In re LongPath Capital, LLC v. Ramtron International Corporation*, the Delaware Court of Chancery again determined the DCF analysis was not appropriate, in this case because it relied on management projections prepared out of the ordinary course of business in anticipation of litigation or a hostile takeover bid and by newer employees who were for the first time creating multi-year projections using a new methodology. Therefore, the merger price, which resulted from a fair process whereby the company's adviser contacted 24 potential buyers, executed non-disclosure agreements with six of them and continued discussions with two companies other than the ultimate buyer before agreeing on a final price, was evidence of fair

41 Steven M Hecht, 'Proposed 2016 Changes to Delaware Appraisal Statute', Appraisal Rights Litigation Blog, 29 March 2016, www.appraisalrightslitigation.com/2016/03/29/proposed-2016-changes-to-delaware-appraisal-statute.

42 *Merlin Partners LP v. AutoInfo, Inc*, 2015 WL 2069417 (Del Ch 30 April 2015); 'Delaware Corporate Law and Litigation: What Happened in 2015 and What It Means for You in 2016', DLA Piper, www.dlapiper.com.

value, and valuation was reached by subtracting the merger's net synergies from the merger price.[43] In October 2015, the Delaware Court of Chancery relied on the merger price in determining fair value in *Merion Capital LP v. BMC Software, Inc*, where the target received multiple offers, negotiated with the ultimate buying consortium and succeeded in having the consortium raise its bid multiple times, and the merger agreement contained a 30-day go-shop period with a robust marketing effort.[44]

In contrast to the preceding examples, in May 2016 the Delaware Court of Chancery held in *In re: Appraisal of Dell Inc* that the fair value of Dell Inc (Dell) was 28 per cent higher than the price paid by the buyers, Michael Dell and Silver Lake Partners (Silver Lake), despite a lengthy, public and well-run sale process.[45] The Court held that the deal price was not the best evidence of Dell's fair value because:

a deal prices generally are a relevant factor in deriving, but are not determinative of, fair value in appraisal proceedings, particularly in cases where other persuasive evidence of fair value (such as comparable companies, comparable transactions and reliable projections) is available; and

b while the sales process was 'praiseworthy' from the perspective of the Dell board meeting its fiduciary duties, several aspects of the sales process made it an imperfect discovery mechanism for the fair value of Dell, including that:
- the deal price was not determined based on an intrinsic valuation of Dell, but rather the maximum price Silver Lake and other private equity firms could pay while still obtaining a desired level of return under their leveraged buyout models;
- there was a significant 'valuation gap' between the market's perception of Dell and its future earnings potential, primarily due to Dell's significant long-term investments in its strategic transformation, which had not yet begun to generate the anticipated results;
- there was limited pre-signing competition (limited to two additional private equity firms and no strategic buyers); and
- the effectiveness of the go-shop process was inhibited by both structural limitations inherent in all management buyouts and specific characteristics of the Dell transaction, including its size and complexity.[46]

Due to the impossibility of quantifying the sales process mispricing, the Court held that a DCF analysis would exclusively be used to derive the fair value of Dell and the deal price would be afforded no weight. While the full impact of the decision is not yet known, and the case may come to be seen as an outlier given that it arose in the context of a management buyout, commentators have warned that the *Dell* decision could result in a further rise in

43 *LongPath Capital, LLC v. Ramtron Int'l Corp*, CA No. 8094-VCP (Del Ch 30 June 2015); 'Delaware Corporate Law and Litigation', footnote 42.

44 *Merion Capital LP v. BMC Software, Inc*, No. 8900VCG (Del Ch 21 October 2015); 'M&A Update: Highlights from 2015 and Implications for 2016', Cadwalader, Wickersham & Taft LLP, 19 January 2016, www.cadwalader.com.

45 *In re Appraisal of Dell Inc*, CA No. 9322-VCL (Del Ch 31 May 2016).

46 Id.

appraisal arbitrage claims, and lead private equity firms and other market participants to seek alternative transaction structures that are detrimental to target shareholders to cap and price appraisal risk.[47]

i Financial advisers' aiding and abetting breaches of fiduciary duty

Over the past few years, Delaware courts have criticised and found financial advisers liable for conflicts of interest and aiding and abetting breaches of fiduciary duty by a company's directors.[48] For a financial adviser, as a non-fiduciary, to be found liable for aiding and abetting a breach of fiduciary duty, there must be a breach of fiduciary duty on which the aiding and abetting liability is predicated, and 'knowing participation in the breach' by the financial adviser.[49]

Nevertheless, an exculpated fiduciary duty claim can be the predicate for an aiding and abetting claim. In *In re TIBCO Software Inc Stockholders Litigation*, the Delaware Court of Chancery refused to dismiss an aiding and abetting claim against the financial adviser even though the fiduciary duty claim against the directors of TIBCO Software Inc (TIBCO) was dismissed; the complaint failed to plead that the directors acted in bad faith, and the directors were exculpated from monetary liability for breaches of the duty of care pursuant to the 102(b)(7) exculpatory provision in TIBCO's charter.[50] While Section 102(b)(7) of the DGCL excludes monetary liability for a director in the event such director fails to use due care, it does not eliminate such director's fiduciary duty to use due care on which an aiding and abetting claim can be based.[51]

The success of an aiding and abetting claim can be impacted by the standard of review applied to the relevant directors' actions. In *In re Zale Corp Stockholders Litigation*, the Delaware Court of Chancery reversed its own decision based on the intervening Delaware Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC* in which the Delaware Supreme Court clarified extensive precedent that the voluntary approval of a merger (other than a merger with a controlling shareholder) by fully informed, disinterested shareholders invoked the business judgment rule standard of review in post-closing damages actions, even where *Revlon*-enhanced scrutiny would otherwise apply.[52] According to the Delaware Supreme Court, *Unocal* and *Revlon* were designed as tools of injunctive relief to address important M&A decisions in real time and not as tools for obtaining post-closing money damages.[53] Based on a strict reading of Supreme Court precedent, the Delaware Court of Chancery had

47 Martin Lipton and Theodore N Mirvis, 'Delaware Court of Chancery Appraises Fully-Shopped Company at nearly 30% Over Merger Price', Harvard Law School Forum on Corporate Governance and Financial Regulation, 3 June 2016, corpgov.law.harvard.edu/2016/06/03/delaware-court-of-chancery-appraises-fully-shopped-company-at-nearly-30-over-merger-price.

48 'M&A Update: Highlights from 2015 and Implications for 2016', footnote 44.

49 *In re TIBCO Software Inc Stockholders Litig*, No. CV 10319-CB, 2015 WL 6155894, at *24 (Del Ch 20 October 2015).

50 Id.

51 *RBC Capital Markets, LLC v. Jervis*, 129 A3d 816, 874 (Del 2015).

52 'Delaware Corporate Law and Litigation', footnote 42; *Corwin v. KKR Fin Holdings LLC*, 125 A3d 304, 309-11 (Del 2015).

53 *Corwin v. KKR Fin Holdings LLC*, 125 A3d at 312.

initially refused to dismiss an aiding and abetting claim against the financial adviser because it found that the plaintiffs sufficiently alleged that the directors acted unreasonably, which amounted to a breach of their duty of care under *Revlon*-enhanced scrutiny, although their actions did not amount to a breach under the business judgment rule, which requires gross negligence.[54] Because the transaction in *In re Zale* had been approved by an uncoerced, fully informed majority of disinterested shareholders, the Delaware Court of Chancery ultimately applied the business judgment rule instead of *Revlon*-enhanced scrutiny, and dismissed the aiding and abetting claim because there was no predicate breach of fiduciary duty on which the aiding and abetting claim could be based.[55]

In *RBC Capital Markets LLC v. Jervis* (more commonly referred to as *Rural/Metro*), the Delaware Supreme Court affirmed the Delaware Court of Chancery's narrow holding that if a financial adviser 'knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum, then [such financial adviser] is liable for aiding and abetting'.[56] While the Delaware Supreme Court affirmed the financial adviser's liability in this case, it also warned against reading its holding expansively to suggest that any failure on the part of financial advisers to prevent a breach of the directors' duty of care gives rise to a claim for aiding and abetting, rejecting the notion put forth by the Delaware Court of Chancery that financial advisers act as 'gatekeepers' of the M&A process and deferring instead to the contractual nature of the role of financial advisers.[57]

ii Forum selection and fee-shifting 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.[58] Plaintiffs engaging in forum shopping (the practice of filing claims in the jurisdiction (or jurisdictions) 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.[59] In response, corporations began enacting charter or by-law amendments to implement forum by-laws, which provisions provide for an exclusive forum (generally their state of incorporation) in which their shareholders could

54 'Delaware Corporate Law and Litigation', footnote 42.

55 *In re Zale Corp Stockholders Litigation*, 2015 WL 5853693 (Del Ch 1 October 2015), reconsideration granted, 2015 WL 6551418 (Del Ch 29 October 2015).

56 *RBC Capital Markets, LLC v. Jervis*, 129 A3d at 862.

57 Id. at 865.

58 '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.

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

bring suit against them over the internal affairs of the corporation, or fee-shifting provisions whereby shareholders bringing suit against them must pay their legal fees in the event such shareholders' suit is unsuccessful.[60]

In 2013, the Delaware Court of Chancery held in *Boilermakers Local 154 Retirement Fund v. Chevron Corporation* that forum by-laws were facially valid under the DGCL, subject to as-applied review to ensure they are not used 'unreasonabl[y] and unjustl[y]'.[61] In 2014, in *City of Providence v. First Citizens BancShares, Inc*, the Delaware Court of Chancery reaffirmed its support of forum by-laws, and granted more flexibility as to the chosen forum and the timing of the by-laws' adoption.[62] *First Citizens* upheld a corporation's selection of its principal place of business as its exclusive forum, which in this case was North Carolina.[63] 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 that is now alleged to be a wrongdoing) rather than on a 'clear day' (in the absence of a simultaneous transaction).[64] 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.[65] Courts in several states have dismissed shareholder litigation on the basis of forum by-laws,[66] although 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', and an Oregon court upheld a similar forum by-law despite it being enacted when a merger agreement was signed.[67]

In 2014, 93 per cent of US M&A deals over $100 million resulted in shareholder litigation, with only 40 per cent of such deal litigation being multi-jurisdictional and such deals facing an average of 4.5 lawsuits.[68] Moreover, only 4 per cent of such deals were challenged in more than two courts, the lowest number since 2007.[69] This is likely the result of the widespread adoption of forum by-laws. More than 300 companies adopted forum by-laws in 2013 and 2014 in the wake of *Boilermakers* and *First Citizens*.[70] Furthermore,

60 'M&A Update: Highlights from 2015 and Implications for 2016', footnote 44; 'Delaware Corporate Law and Litigation', footnote 42.

61 *Boilermakers Local 154 Ret Fund v. Chevron Corp*, 73 A3d 934, 957 (Del Ch 2013).

62 *City of Providence v. First Citizens BancShares, Inc*, 99 A3d 229 (Del Ch 2014).

63 Id. at 240.

64 Id. at 241.

65 Id.

66 'Exclusive Forum By-laws Gain Momentum', footnote 59.

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

68 'Shareholder Litigation Involving Acquisitions of Public Companies – Review of 2014 M&A Litigation', Cornerstone Research (2015), www.cornerstone.com.

69 Id.

70 Id.

following the rejection of disclosure-only settlements by the Delaware Court of Chancery in, among other cases, *Acevedo v. Aeroflex Holding Corp* and *In re Aruba Networks, Inc* in the latter half of 2015 (see Section V.iii, *infra*, for further discussion of disclosure-only settlements), litigation was initiated in respect of only 21.4 per cent of completed transactions for the fourth quarter of 2015, compared to 87.7 per cent for calendar year 2015.[71]

In 2014, in *ATP Tour, Inc et al v. Deutscher Tennis Bund et al*, the Delaware Supreme Court, sitting *en banc*, held that a fee-shifting by-law is facially valid in 'that it is permissible under the DGCL, and that it may be enforceable if adopted by the appropriate corporate procedures and for a proper corporate purpose'.[72] The Court also held that the fact that a by-law is adopted after a member joins the corporation does not affect its enforceability where such member agrees to be bound by the corporation's by-laws, which 'may be adopted and/or amended from time to time' by the board.[73] After *ATP*, many corporations adopted fee-shifting provisions in their by-laws.[74]

Legislation became effective in Delaware on 1 August 2015, which formally authorised certificates of incorporation or by-laws to include forum by-laws providing for Delaware as the exclusive forum.[75] The legislation also invalidated forum by-laws that select another forum to the exclusion of Delaware while neither expressly authorising nor expressly prohibiting selecting a forum in addition to Delaware.[76] In response to *ATP*, the Delaware legislature also passed legislation, which became effective on 1 August 2015, prohibiting fee-shifting provisions, although the legislation does not apply to non-stock corporations.[77]

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

Calendar year 2015 saw 1,551 US targeted cross-border M&A deals, the highest annual deal volume since 2007, which saw 1,568 such deals announced according to Dealogic. These 1,551 deals had an aggregate deal value of $469.07 billion, the highest annual deal value in the past two decades, compared to $270.72 billion in 2014, $143.56 billion in 2013 and $357.74 billion in 2007. Canada, the UK, Japan and China led US targeted cross-border M&A activity by number of deals in both 2015 and 2014.

i Acquisition inversions

By November 2015, acquisition inversions, whereby US corporations reincorporate in low-tax jurisdictions via cross-border M&A (hereinafter, 'inversions'), accounted for 66 per cent of all proposed US outbound deals for the year as compared to only 1 per cent of

71 Matthew D Cain and Steven Davidoff Solomon, 'Takeover Litigation in 2015 (Preliminary Figures)' (14 January 2016), available at papers.ssrn.com/sol3/papers.cfm?abstract_id=2715890. (Qualifying transactions, among other factors, had a publicly listed target and a total transaction value of at least $100 million).

72 *ATP Tour, Inc v. Deutscher Tennis Bund*, 91 A3d 554, 559 (Del 2014).

73 Id. at 560.

74 'Delaware Corporate Law and Litigation', footnote 42.

75 8 Del C Section 115; 'Delaware Corporate Law and Litigation', footnote 42.

76 8 Del C Section 115.

77 8 Del C Section 102(f), 109(b), 114(b)(2); 'Delaware Corporate Law and Litigation', footnote 42.

US outbound deals in 2011.[78] 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.[79] For this to work, 25 per cent of the company's sales, assets and employees had to be domiciled in the new jurisdiction.[80] This is a difficult burden for most companies to meet, and in the past few years inversions have become popular.[81] Under the rules governing 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.[82] While inversions, as a phenomenon, have not gone away, the pace at which they occur has slowed due to the implementation of a series of governmental measures in late 2014, late 2015 and early 2016.

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.[83] In October 2014, Endo International PLC then announced its $2.6 billion acquisition of Auxilium Pharmaceuticals Inc, based in Chesterbrook, PA, which closed in January 2015.[84] Also in January 2015, Minneapolis-based Medtronic, Inc closed its $49.9 billion acquisition of Covidien plc through the creation of a new holding company, Medtronic plc, incorporated in Ireland, reducing Medtronic's corporate tax rate by between one and two percentage points and providing Medtronic with access to some of its foreign cash.[85] In February and

78 'The continuing appeal of inversions', *Financier Worldwide*, November 2015, www.financierworldwide.com/the-continuing-appeal-of-inversions/#.V0S9fmcUVaR.

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

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

81 Id.

82 Press release, Department of the Treasury, 'Fact Sheet: Treasury Actions to Rein in Corporate Tax Inversions', 22 September 2014, www.treasury.gov/press-center/press-releases/Pages/jl2645.aspx.

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

84 'Endo Completes Acquisition of Auxilium Pharmaceuticals', PR Newswire, 29 January 2015, www.prnewswire.com/news-releases/endo-completes-acquisition-of-auxilium-pharmaceuticals-300028144.html.

85 Ezequiel Minaya, 'Medtronic Not Concerned About Latest U.S. Effort to Curb Tax Inversions', *Wall Street Journal*, 20 November 2015, www.wsj.com/articles/medtronic-not-concerned-about-latest-u-s-effort-to-curb-tax-inversions-1448023313?cb=logged0.484447700560936; David Crow, 'Medtronic: the tax inversion that got away', *Financial Times*, 27 January 2015, www.ft.com/intl/cms/s/0/ddcd9ad6-a5cf-11e4-ad35-00144feab7de.

May 2015, respectively, Cyberonics Inc and Sorin Spa announced its nearly $3 billion deal to merge into a new company domiciled in the UK, which has a lower corporate tax rate than the US, and Avago Technologies Ltd, based in Singapore, announced its $37 billion takeover of Broadcom Corp in CA.[86] In November 2015, Steris Corp of Mentor, OH closed its $1.9 billion acquisition of Synergy Health plc in the UK, which was originally announced in October 2014.[87] Steris Corp is now Steris plc, a British company.[88] In January 2016, Tyco announced its $3.9 billion purchase of Johnson Controls, a Milwaukee-based company, which would be relocated to Cork, Ireland, where Tyco is domiciled.[89] The deal is expected to close in September 2016 and to result in at least $150 million savings in annual tax payments.[90] In January 2016, ARRIS Group of Suwanee, GA closed its $2.1 billion acquisition of UK-based Pace, previously announced in April 2015, and reincorporated in the UK as part of the acquisition, becoming a subsidiary of a new UK holding company, ARRIS International.[91] ARRIS expects a reduction in its corporate tax rate as a result of the transaction on both a GAAP and non-GAAP basis.[92]

In April 2016, the $152 billion Pfizer–Allergan deal was abandoned after the IRS issued regulations, which formalised Notices 2014-52 (issued in late 2014) and 2015-79 (issued in late 2015) and targeted serial inverters and post-inversion asset dilution (see Section VIII, *infra*, for further discussion on Notice 2015-79 and the April 2016 regulations).[93] Governmental measures against inversions are not new, and attempts to rein in such

html; 'Medtronic Acquisition of Covidien Frequently Asked Questions for Shareholders', Medtronic, 26 January 2015, phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9Mjc2MTUwfENoaWxkSUQ9LTF8VHlwZT0z&t=1.

86 James Fontanella-Khan, 'Cyberonics and Sorin merge in $3bn deal with relocation to London', *Financial Times*, 26 February 2015, www.ft.com/intl/cms/s/0/196f9550-bd39-11e4-9902-00144feab7de.html; Oliver Staley and Anjali Cordeiro, 'Medical-Device Makers Cyberonics, Sorin to Form U.K. Company', Bloomberg, 26 February 2015, www.bloomberg.com/news/articles/2015-02-26/medical-device-makers-cyberonics-sorin-to-combine-as-u-k-firm; Antoine Gara, 'Could Avago Become the Valeant Pharmaceuticals of The Semiconductor Sector?', *Forbes*, 28 May 2015, www.forbes.com/sites/antoinegara/2015/05/28/could-avago-become-the-valeant-pharmaceuticals-of-the-semiconductor-sector/#3a956e996bc3.

87 'Steris Corp. completes $1.9 billion acquisition of Synergy Health, *Crain's Cleveland Business*, 2 November 2015, www.crainscleveland.com/article/20151102/NEWS/151109988/steris-corp-completes-1-9-billion-acquisition-of-synergy-health.

88 Id.

89 Leslie Picker, 'Tyco Merger Will Shift Johnson Controls' Tax Liability Overseas, *New York Times*, 25 January 2016, www.nytimes.com/2016/01/26/business/dealbook/johnson-controls-to-combine-with-tyco-in-tax-inversion-deal.html?_r=0.

90 Id.

91 Meredith Hobbs, 'Troutman Advises ARRIS on $2.1B Cross-Border Buy of Pace', *Daily Report*, 6 January 2016, www.dailyreportonline.com/id=1202746450379/Troutman-Advises-ARRIS-on-21B-CrossBorder-Buy-of-Pace?slreturn=20160424214556.

92 Id.

93 Donald J Marples and Jane G Gravelle, 'Corporate Expatriation, Inversions, and Mergers: Tax Issues', Congressional Research Service, 27 April 2016, www.fas.org/sgp/crs/misc/R43568.pdf.

transactions have continued as the government sees more and more taxable revenue escaping its reach.[94] Anti-inversion legislation is highly unlikely this year given the upcoming US presidential election,[95] and the new regulations' long-term impact is still uncertain. 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

The 2014 CFIUS annual report to Congress, published in February 2016, reveals an overall expansion of CFIUS review: an upward trend in the number of notices filed and an increase in the number of cases submitted to the investigation stage.[96] This expansion may push CFIUS review to become a systematic consideration in negotiations among parties undertaking M&A transactions.

CFIUS review is formally a three-step process, with an initial informal review step having evolved over time to give both the parties to an M&A transaction and the CFIUS additional time to work out any national security concerns without the time constraints imposed by the formal review process.[97] The formal review process is usually (although not exclusively) initiated based on the filing of voluntary notices, and 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. Since 2000, only five transactions have progressed to the third step: a presidential review and final determination, which determination itself is not subject to judicial review.[98] In 2014, the CFIUS conducted investigations on 35 per cent of notices filed, down from 49 per cent in 2013, which percentage was inflated due in part to incomplete first-stage reviews caused by the government's shutdown in October 2013, and 39 per cent in 2012.[99]

Mitigation measures were applied to 6 per cent of reviewed transactions in 2014, as compared to 8 per cent for the three-year period from 2012 through 2014.[100] Mitigation measures are an informal practice whereby the CFIUS is authorised to enter into agreements with the parties to a proposed transaction to alleviate some of the national security concerns raised by such transaction. Such measures in 2014 included, *inter alia*, notifying security officers or relevant government parties in advance of any foreign national visits for approval, providing the government with the right to review and object to certain business decisions,

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94 Gelles, 'New Corporate Tax Shelter', footnote 79.

95 'New Treasury rules take aim at tax inversions', *Los Angeles Times*, 5 April 2016, www.latimes.com/business/la-fi-tax-inversions-20160405-story.html.

96 'Comm. On Foreign Inv. in the U.S.', Annual Report To Congress (2014), 3 (Annual Report).

97 James K Jackson, 'The Committee on Foreign Investment in the United States (CFIUS)', Congressional Research Service, 19 February 2016, www.fas.org/sgp/crs/natsec/RL33388.pdf.

98 Nicholas Spiliotes, Aki Bayz and Betre Gizaw of Morrison & Foerster, 'Getting the Deal Done: China, Semiconductors, and CFIUS', *The M&A Journal*, Vol. 16 No. 5, www.mofo.com/~/media/Files/Articles/2016/04/160400ChinaSemiconductorsCFIUS.pdf.

99 Annual Report at 3.

100 Id. at 23.

ensuring only authorised personnel has access to certain technology and information, and ensuring only US citizens handle certain products or services.[101] Filing a notice to the CFIUS is a voluntary measure, but the CFIUS may review a transaction at its discretion even after it is completed. Measures imposed after a deal closes may affect a party's anticipated benefits, and the rise in CFIUS reviews may push parties to an M&A transaction to address the possibility of such measures early on in the transaction process.

CFIUS review is not only becoming more commonplace; it could become more costly. In 2014, the CFIUS approved the withdrawal of 12 notices, three during the initial 30-day review period and nine during the second 45-day investigation period.[102] In one of these cases, a new notice was filed in 2015.[103] In January 2016, after the CFIUS raised concerns, Chinese private equity fund Go Scale Capital and Dutch company Royal Philips announced the termination of their March 2015 agreement for Go Scale Capital to acquire a portion of Royal Philips' lighting business.[104] Even though neither party to the transaction was based in the US, the lighting business that was at the heart of the transaction owns a large portfolio of US patents for light-emitting diodes, and has a significant presence in the US through manufacturing and research and development facilities.[105] In February 2016, Fairchild Semiconductor rejected an acquisition offer from China Resources Microelectronics and Hua Capital Management, despite a higher bid, due to CFIUS risk.[106] Again in February 2016, China's Tsinghua University's Unisplendour Corp backed out of its effort to acquire a 15 per cent stake in Western Digital Corp, which would have entitled it to one seat on the board, after the CFIUS announced it could not approve the transaction during the initial 30-day review.[107] Failure to obtain regulatory approvals can trigger break-up fees for acquirers, and the rise in CFIUS reviews could push more M&A parties to address it in termination fee provisions. Moreover, given that China accounted for the most CFIUS notices, by country, in each of the three years from 2012 to 2014, Chinese buyers may have to offer a higher bid to overcome a perceived increased CFIUS risk.[108]

101 Id.

102 Annual Report at 22.

103 Id.

104 Zachary Brez and Samad Pardesi, 'Interesting Times Ahead For CFIUS And Foreign Investors', *Law360*, 17 March 2016, www.law360.com/articles/769470/interesting-times-ahead-for-cfius-and-foreign-investors; Shayndi Raice, 'Europe-China Deals Get More U.S. Scrutiny', *Wall Street Journal*, 24 January 2016, www.wsj.com/articles/europe-china-deals-get-more-u-s-scrutiny-1453680070.

105 Raice, 'Europe-China Deals Get More U.S. Scrutiny', footnote 104.

106 Brez and Pardesi, 'Interesting Times Ahead For CFIUS And Foreign Investors', footnote 104.

107 Id.

108 Annual Report at 18; Raice, 'Europe-China Deals Get More U.S. Scrutiny', footnote 104.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

i Healthcare

Calendar year 2015 was a record-breaking year for healthcare, with 1,460 deals worth approximately $563 billion and almost every subsector experiencing M&A growth.[109] In the hospital subsector, although 2015 saw 101 announced deals, the highest annual deal count seen over the past decade, surpassing the previous 2012 record of 94 deals, transactions have moved away from traditional M&A activity towards joint ventures, combinations, affiliations and partnerships.[110] Smaller hospitals are looking to partner with larger health systems to help bear the costs associated with the Affordable Care Act that are not covered by Medicaid.[111] In the managed care subsector, M&A activity by dollar volume exceeded $100 billion as compared to $930 million in 2014 and $51 million in 2013, and there was an 86.4 per cent increase in deal count compared to 2014.[112] In addition, this subsector saw the announcement of a series of mega-deals in July 2015 shortly after the Supreme Court saved the federal health insurance exchanges in its *King v. Burwell* decision.[113] These mega-deals involved four of the five largest public health insurers (as ranked by total 2014 revenue).[114] The long-term care subsector witnessed in 2015 its third straight year of more than doubling the M&A deal count of the next comparable healthcare services subsector, with 354 deals comprising approximately 24 per cent of the total healthcare deal count.[115] However, the M&A activity in the long-term care subsector was driven mainly by smaller size or unpublished deals, and included only one deal over $1 billion.[116] The physician practice subsector continued its trend from 2014, whereby physician management companies were very active in acquiring complementary physician groups in order to gain scale, expand their existing customer base and position themselves to move towards value-based reimbursement.[117] This subsector saw 78 announced deals in 2015, representing a 35 per cent increase in deal count but a 26 per cent decrease in dollar volume from 2014.[118] However, 2014 included two deals that accounted for nearly $3 billion of the $3.2 billion dollar volume disclosed for 2014.[119]

109 'US health services deals insights: Analysis and trends in US health services activity 2015 and 2016 outlook', PricewaterhouseCoopers LLP, February 2016, www.pwc.com/us/en/healthcare/publications/assets/pwc-health-services-deals-insights-q4-2015.pdf.

110 Id.

111 Id.

112 Id.

113 Id.; 'King v. Burwell', SCOTUSblog, www.scotusblog.com/case-files/cases/king-v-burwell (last visited 29 May 2016).

114 'US health services deals insights', footnote 109.

115 Id.

116 Id.

117 Id.

118 Id.

119 Id.

ii Shareholder activism and engagement

In 2013, shareholder activism went mainstream; in 2014 and 2015, it exploded. In 2015, activists launched 507 campaigns globally and 360 campaigns in the US, the highest number of campaigns on record both globally and in the US.[120] Perhaps encouraged by their continued prominence and success – activists saw a success rate in the US of 68.6 per cent of resolved activist demands at least partially satisfied in 2015, up from 65.6 per cent in 2014 – activists continue to target large companies, and have influenced and played a key role in extraordinary transactions, including spin-offs, dispositions and share buybacks.[121] Worldwide, activist funds held $249.8 billion worth of stocks (excluding activist short positions) and managed total assets of $173 billion.[122] Additionally, more and more companies are being targeted by 'occasional' activists who engage management only every so often as opposed to activists who engage management at most of the companies in which they invest or several companies per year.[123] In 2015, 51 per cent of activists were occasional activists, up from 47 per cent in 2014 and 31 per cent in 2013.[124] Of the targeted companies, 14 per cent had a market capitalisation over $10 billion.[125] In the US, services and technology comprised 24 per cent and 19 per cent of targeted companies in 2015, respectively, compared to 22 per cent and 16 per cent globally.[126] The proportion of healthcare campaigns in the US also rose from 8 per cent in 2014 to 11 per cent in 2015, while remaining broadly flat globally.[127] With the rise in shareholder activism, companies have increased their level of shareholder engagement with both activists and institutional investors.[128] In 2015, 56 per cent of S&P 500 companies disclosed information regarding their shareholder engagement activities in their SEC filings, compared to only 6 per cent in 2010.[129]

Several notable US public M&A deals resulted either directly or indirectly from shareholder activism.[130] In May 2015, Ascena Retail Group Inc (Ascena) agreed to a $2.2 billion acquisition of Ann Inc, eight months after activist funds Engine Capital LP and Red Alder LLC urged Ann Inc to sell itself for as much as $3 billion, citing competitors Chico's, J Crew and Ascena as potential buyers.[131] In July 2015, MeadWestvaco Corp and Rock-Tenn Co officially closed their merger of equals, originally announced in January 2015 after an

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120 'M&A Update: Highlights from 2015 and Implications for 2016', footnote 44; 'Activist Investing: An Annual Review of Trends in Shareholder Activism', Schulte Roth and Zabel, www.valuewalk.com/wp-content/uploads/2016/01/The-Activist-Investing-Annual-Review-2016._260.pdf (last visited 27 May 2016).

121 Id.

122 'Activist Investing: An Annual Review of Trends in Shareholder Activism', footnote 120.

123 Id.

124 Id.

125 Id.

126 Id.

127 Id.

128 'M&A Update: Highlights from 2015 and Implications for 2016', footnote 44.

129 Id.

130 'What's Market: 2015 Public M&A Wrap-up', footnote 12.

131 Tom Zanki, 'Lane Bryant Owner Pays $2.2B For Ann Taylor Parent Co.', *Law360*, 18 May 2015,www.law360.com/articles/657005/lane-bryant-owner-pays-2-2b-for-ann-taylor-parent-co.

activist shareholder campaign at MeadWestvaco Corp by Starboard Value pushed for the company to spin-off its chemicals business.[132] The spin-off of MeadWestvaco Corp's chemicals business was then completed in May 2016.[133] In October 2015, Dell Inc formally announced its agreement to acquire EMC Corp for approximately $67 billion in the second-largest technology merger of all time, with support from activist investor Elliott Management Corporation, which had begun publicly urging EMC Corp in October 2014 to pursue a sale.[134] In December 2015, after activist campaigns at both companies, an agreement was reached between Dow Chemical Company (Dow Chemical) and E I du Pont de Nemours and Company (DuPont) for a $68.4 billion merger of equals, followed by the breaking up of the combined company into three separate businesses.[135] Dan Loeb's activist fund Third Point LLC (Third Point) had been calling for Dow Chemical to spin-off a portion of its business since early 2014, and in November 2014, Dow Chemical avoided a proxy fight by agreeing to add four independent directors to its board, including two Third Point nominees.[136] Although Nelson Peltz's activist fund Trian Partners (Trian) lost its proxy fight against DuPont in May 2015, DuPont took many of the steps urged by Trian before its annual meeting, DuPont's CEO abruptly resigned in October 2015 following a decline in DuPont's stock price and a cut in its 2015 earnings forecast, and the deal with Dow Chemical represented a win for Trian, which had called for breaking up DuPont.[137]

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

132 'What's Market: 2015 Public M&A Wrap-up', footnote 12; Jacob Geiger, 'MeadWestvaco officially completes merger with Rock-Tenn', *Richmond Times-Dispatch*, 1 July 2015, www.richmond.com/business/local/article_62c8932e-7d73-5516-9334-fc455590b689.html; Michael J De La Merced, 'Packaging Giants RockTenn and MeadWestvaco to Merge', *New York Times*, 26 January 2015; dealbook.nytimes.com/2015/01/26/rock-tenn-and-meadwestvaco-2-packaging-giants-to-merge/?_r=0.

133 'Ingevity Corporation Formed with Completion of Spinoff from WestRock Company', BusinessWire, 16 May 2016; www.businesswire.com/news/home/20160516005161/en/Ingevity-Corporation-Formed-Completion-Spinoff-WestRock-Company.

134 'What's Market: 2015 Public M&A Wrap-up', footnote 12; Dan Primack and Barb Darrow, 'Dell and EMC make their mega-merger official', *Fortune*, 12 October 2015, fortune.com/2015/10/12/dell-and-emc-merger-official.

135 'What's Market: 2015 Public M&A Wrap-up', footnote 12; 'Dow Chemical, Dan Loeb settle board debate', Reuters, 21 November 2014, www.reuters.com/article/us-dowchemical-thirdpoint-board-idUSKCN0J51SX20141121.

136 Id.

137 'What's Market: 2015 Public M&A Wrap-up', footnote 12; Jacob Bunge and David Benoit, 'DuPont Defeats Peltz, Trian in Board Fight', *Wall Street Journal*, 13 May 2015, www.wsj.com/articles/dupont-appears-poised-to-win-over-peltz-1431521564; Jack Kaskey and Carol Hymowitz, 'Kullman to Leave DuPont as Activist Signals New Breakup Push', *Bloomberg*, 5 October 2015, www.bloomberg.com/news/articles/ 2015-10-06/kullman-to-leave-dupont-as-activist-signals-new-push-for-breakup; 'Activist Investing: An Annual Review of Trends in Shareholder Activism', footnote 120.

picture as they respond to immediate pressures. Moreover, activist short-sellers are on the rise, targeting 143 companies in 2015, including 41 technology companies, as compared to 105 companies in 2014.[138]

However, while activist investors enjoyed increased activity and success in resolving their demands, activist fund performance and market reaction has been down. The Activist Insight Index, compiled from more than 30 activist funds operating in different markets, was down more than 3 per cent, after fees, for the first three quarters of 2015, and at the end of 2015, activist-targeted US stocks were down 7.7 per cent on an annualised basis.[139] Pershing Square Capital Management, ranked one of Activist Insight's top 10 activists by impact, ended 2015 down 21 per cent, as compared to a return of over 40 per cent in 2014, and LionEye Capital closed at the end of 2015 following withdrawals.[140] Moreover, M&A activism had the lowest success rate of all activist demands in 2015.[141]

iii Disclosure-only settlements

In 2014, 93 per cent of US M&A deals over $100 million resulted in shareholder litigation (as previously mentioned), with the first lawsuit in a challenged deal being filed an average of 14 days after announcement of the deal and 59 per cent of all such litigation being resolved before deal closing.[142] Of the litigation resolved before closing, close to 90 per cent settled, with the remainder being withdrawn or dismissed.[143] Of the 78 settlements reached in 2014, only six settlements, or 8 per cent, provided monetary consideration to shareholders, nearly 80 per cent only provided disclosure and 9 per cent included changes to deal protection provisions in the merger agreements.[144]

While criticism of routine disclosure-only settlements has been building within the Delaware Court of Chancery over the past few years, as previously mentioned the Court was particularly critical in 2015, resulting in the rejection of two such proposed settlements in key cases: *Acevedo v. Aeroflex Holding Corp* and *In re Aruba Networks, Inc*[145] Such rulings may lead to fewer M&A challenges in Delaware, and, in fact, over the first nine months of 2015, 78 per cent of Delaware companies that sold themselves faced a lawsuit in Delaware, but in the last three months of 2015, after Vice Chancellor J Travis Laster rejected the two proposed disclosure-only settlements, only 34 per cent of such M&A deals were challenged in Delaware.[146] In addition to fewer lawsuits being filed, earlier cases were abandoned in light of this shift in the Court's approach to disclosure-only settlements, and at least four proposed

138 'Activist Investing: An Annual Review of Trends in Shareholder Activism', footnote 120.

139 Id.

140 Id.

141 Id.

142 'Shareholder Litigation Involving Acquisitions of Public Companies –Review of 2014 M&A Litigation', footnote 68.

143 Id.

144 Id.

145 'The Shifting Landscape in M&A Litigation', Hunton and Williams LLP, January 2016, www.hunton.com.

146 Liz Hoffman, 'The Judge Who Shoots Down Merger Lawsuits', *Wall Street Journal*, 10 January 2016, www.wsj.com/articles/the-judge-who-shoots-down-merger-lawsuits-1452076201.

disclosure-only settlements were withdrawn.[147] It remains to be seen if this trend will continue. A study also found a 10 per cent drop from 2014 to 2015 in cases with a Delaware connection being filed in Delaware, suggesting plaintiffs' lawyers may seek to obtain disclosure-only settlements in jurisdictions other than Delaware, although corporations can utilise forum by-laws, recently expressly authorised in the DGCL, to keep cases within Delaware.[148]

In its January 2016 decision in *In re Trulia*, the Delaware Court of Chancery reaffirmed its disfavour of disclosure-only settlements in class action M&A litigation on the basis that such settlements fail to create meaningful value for the class while providing defendants with broad releases.[149] In its opinion, the Court referenced a study suggesting that supplemental disclosures have no impact on shareholder voting and thus provide no benefit to shareholders that could serve as consideration for the broad releases typically sought in disclosure-only settlements.[150] The opinion also references a paper that highlights claims almost released in settlement that later provided shareholders with significant recoveries.[151]

In re Trulia forged a new path going forward whereby disclosure-only settlements will continue to be disfavoured by the Delaware Court of Chancery unless the suggested supplemental disclosures 'address a plainly material misrepresentation or omission', and the proposed release relates only to the disclosure claims and fiduciary duty claims concerning the sale process, which have been investigated sufficiently.[152] *In re Trulia* also endorsed a different mechanism for resolving such M&A litigation: mootness dismissal.[153] In a mootness dismissal, the plaintiffs would dismiss, without prejudice to other members of the class, the disclosure claims mooted by supplemental disclosures provided by the defendants.[154] The parties would then be free to negotiate attorneys' fees, without needing court approval, which would, however, require notification to the shareholders, who could then object if the circumstances warrant.[155]

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

While robust acquisition financing markets went hand-in-hand with the mega-deals and record volume of M&A in 2015, the credit markets were volatile, shifting fundamentally and declining significantly as the year progressed, in part due to the anticipated first US federal rate increase since 2006.[156] Overall, US debt capital markets in 2015 once again saw the year's dollar volume of US investment grade debt issuances inch past the previous year's

147 Id.; 'Takeover Litigation in 2015', footnote 71.

148 Brian M Lutz and Vivek Gopalan, 'M&A Litigation in Delaware After 'Trulia'', Delaware Business Court Insider, 24 February 2016, www.delbizcourt.com/id=1202750511525/MampA-Litigation-in-Delaware-After-Trulia?slreturn=20160427233310.

149 'Delaware Corporate Law and Litigation', footnote 42.

150 *In re Trulia, Inc Stockholder Litig*, 129 A3d 884, 895 (Del Ch 2016).

151 Id.

152 Id. at 898.

153 Id. at 897.

154 Id.

155 Id. at 898.

156 Eric M Rosof, 'Acquisition Financing: the Year Behind and the Year Ahead', Harvard Law School Forum on Corporate Governance and Financial Regulation, 21 January 2016,

all-time high, exceeding the $1 trillion mark for the fourth year in a row with $1.2 trillion, up 8 per cent from the previous year.[157] High-yield debt issuances decreased, with 2015 proceeds down 17.8 per cent as compared to 2014, for a total of $253 billion.[158] US syndicated lending decreased slightly from 2014, down 2 per cent, with total dollar volume of $2.2 trillion.[159] US leveraged lending decreased significantly from 2014, with US leveraged loan volume dropping 25.6 per cent, from $1.2 trillion to $865.4 billion.[160] Like the previous year, 2015 was driven by multiple mega-deals in the financing realm as well as the M&A realm.[161] 2015 saw 13 deals each with a principal amount over $10 billion, which together raised a total of $180.5 billion.[162] The top three syndicated loan acquisition financings were Charter Communication Inc's acquisition of Time Warner Cable and Bright House Networks with a syndicated loan of $30.5 billion, followed by Anthem, Inc's $30 billion loan to purchase Cigna Corp and AbbVie Inc's $18 billion loan to acquire Pharmacyclics Inc.[163] The bond market was heavily driven not only by mega-deals, including acquisition financings, but also strong investment grade activity, particularly given the decline in the high-yield debt market.[164] In the first nine months of 2015, US bond issuances reached $1.04 trillion, the highest level for that period of a year on record according to Dealogic, marking the second time US bond issuances crossed the $1 trillion threshold for that period.[165]

The end of 2015 saw a decrease in leveraged buyouts and corresponding leverage, leveraged loans, high-yield bonds and second lien debt, an increase in the price of risk and elevated levels of distress.[166] As of 31 December 2015, about 13 per cent, by volume and number, of all outstanding first lien loans were trading in the secondary market at a distressed price, and leveraged loans in default or bankruptcy were at their highest level since

corpgov.law.harvard.edu/2016/01/21/acquisition-financing-the-year-behind-and-the-year-ahead-2; Debt Capital Markets Review, Full Year 2015, Managing Underwriters, Thomson Reuters (2015), share.thomsonreuters.com/general/PR/DCM-4Q15-(E).pdf.

157 Debt Capital Markets Review, Full Year 2015, Managing Underwriters, footnote 156.

158 Id.

159 Global Syndicated Loans Review, Full Year 2015, Managing Underwriters, Thomson Reuters (2015), share.thomsonreuters.com/general/PR/Loan-4Q15-(E).pdf.

160 Id.

161 Debt Capital Markets Review, Full Year 2015, Managing Underwriters, footnote 156.

162 Id.

163 Id.; 'Charter Communications sees $30B in debt commitments for TWC, Bright House M&A', LeveragedLoan.com, 1 June 2015, www.leveragedloan.com/charter-communications-sees-30b-in-debt-commitments-for-twc-bright-house-ma; Anna Wilde Mathews, 'Anthem Agrees to Buy Cigna for $48.4 Billion', *Wall Street Journal*, 24 July 2015, www.wsj.com/articles/anthem-agrees-to-buy-cigna-for-48-billion-1437732331; Karen Schwartz, 'Surging M&A boosts US bridge loan issuance: TRLPC', Reuters, 29 July 2015, www.reuters.com/article/us-bridge-volume-idUSKCN0Q32A320150729.

164 Sarah Krouse, 'Record Year for U.S. Corporate Bond Deals', *Wall Street Journal*, 25 September 2015, blogs.wsj.com/moneybeat/2015/09/25/corporate-bond-issuance-tops-1-trillion-in-u-s.

165 Id.

166 'Credit Markets Update As of December 31, 2015', KPMG Corporate Finance LLC (2016), corporatefinance.kpmg.us/content/dam/info/corporate-finance/publications/kpmg-cf-creditmarkets-q42015.pdf.

2009, if measured by par amount outstanding, or 2010, if measured by percent of loans outstanding.[167] Moreover, funds flows to leveraged loan funds, while positive, were subdued as compared to previous quarters, and funds flows to high-yield funds were negative for the last three quarters of 2015.[168]

In the first quarter of 2016, driven by multi-billion dollar acquisition financings, US investment grade debt issuances broke the standing first quarter record for the fifth year in a row with $352.1 billion, up 1 per cent from the previous year.[169] High-yield debt issuances further crashed, with first quarter 2016 proceeds down 74.3 per cent as compared to first quarter 2015, for a total of $19.3 billion.[170] Syndicated lending also decreased sharply, with first quarter overall US syndicating lending and US leveraged loan values decreasing 18 per cent and 51 per cent, respectively, as compared to the first quarter of 2015.[171]

Due to the weakness in the high-yield bond market, private equity firms are finding it difficult to obtain the financing needed to close their most highly leveraged buyouts.[172] In December 2015, Sycamore Partners completed its acquisition of Belk, Inc only after Belk, Inc discounted the acquisition financing debt to 89 cents on the dollar the previous month.[173] In January 2016, KKR & Co LP failed to secure any bank financing and raised the money itself for its $1.2 billion acquisition of Mills Fleet Farm.[174] Also in January 2016, Carlyle Group LP renegotiated the terms of its deal with Symantec Corp to purchase Symantec's data storage business, Veritas Software Corporation, lowering the purchase price by $600 million.[175] According to Dealogic, another 20 highly leveraged buyout deals were still pending as of January 2016, with a total value of nearly $4 billion.[176]

VII EMPLOYMENT LAW

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) enacted in 2010, shareholders of publicly traded companies in the US are privy to extensive disclosure, and have a significant voice, regarding the material components of

167 Id.

168 Id.

169 Debt Capital Markets Review, First Quarter 2016, Managing Underwriters, Thomson Reuters (2016), share.thomsonreuters.com/general/PR/DCM_1Q16_E.pdf.

170 Id.

171 Global Syndicated Loans Review, First Quarter 2016, Managing Underwriters, Thomson Reuters (2016), share.thomsonreuters.com/general/PR/Loan_1Q16_E.pdf.

172 James Fontanella-Khan and Eric Platt, 'Buyout firms lose leverage with backers', *Financial Times*, 21 January 2016, www.ft.com/intl/cms/s/0/3ace5424-bfdc-11e5-9fdb-87b8d15baec2.html.

173 Id.; Koh Gui Qing and Greg Roumeliotis, 'Private equity deals hit as banks curb lending for leveraged buyouts', Reuters, 15 January 2016, www.reuters.com/article/us-privateequity-deals-insight-idUSKCN0UT1GG; 'Sycamore Partners Completes Acquisition of Belk, Inc', PR Newswire, 10 December 2015, www.prnewswire.com/news-releases/sycamore-partners-completes-acquisition-of-belk-inc-300191462.html.

174 Qing and Roumeliotis, 'Private equity deals hit as banks curb lending', footnote 173.

175 Fontanella-Khan and Platt, 'Buyout firms lose leverage with backers', footnote 172.

176 Id.

such companies' executive pay practices. In 2015, the SEC issued several proposed and final regulations implementing the Dodd-Frank Act, shareholders and institutional shareholder advisory services remained active, and several cases brought new questions regarding director compensation before the courts. As certain problematic 'legacy' pay practices are phased out, companies are crafting increasingly complex pay-for-performance programmes to better respond to shareholder and institutional investor concerns, but the long-term effects of the regulatory changes remain unclear.

i SEC proposed and final regulations

In February 2015, the SEC issued proposed regulations implementing Section 955 of the Dodd-Frank Act, requiring the disclosure of corporate hedging policies, and in July 2015, the SEC issued proposed regulations requiring listing exchanges to develop clawback policies relating to incentive-based compensation.[177] In April 2015, the SEC issued proposed regulations implementing Section 953(a) of the Dodd-Frank Act, referred to as the pay versus performance rules.[178] The proposed pay versus performance rules would require companies to disclose compensation 'actually paid' to the principal executive officer and the average compensation 'actually paid' to other named executive officers, on the one hand, and total shareholder return (TSR) and peer group TSR, on the other.[179] The disclosure is meant to assist shareholders in 'exercising their rights to cast advisory votes on executive compensation' and provide a 'new metric for assessing a registrant's executive compensation relative to its financial performance'.[180]

In August 2015, the SEC adopted the final implementing rule for Section 853(b) of the Dodd-Frank Act, referred to as the pay-ratio rule.[181] For fiscal years starting on or after 1 January 2017, public companies will be required to disclose the median of annual total compensation of all company employees, the annual total compensation of the CEO and the ratio of the two amounts. Additional disclosure about the selection of the median employee, the calculations involved in determining total compensation and narratives discussing the ratio will be necessary. Again, the disclosure is meant to 'provide shareholders with information they can use to evaluate a CEO's compensation' in the form of a 'company-specific metric'.[182] The implementation costs of the pay-ratio rule are estimated to be significant, and whether the increased disclosure will prove useful to shareholders remains to be seen.

177 US Securities and Exchange Commission, Release No. 33-9723; US Securities and Exchange Commission, Release No. 33-9861.

178 US Securities and Exchange Commission, Release No. 34-74835.

179 Compensation 'actually paid' is an executive's total compensation as disclosed in the summary compensation table (already included in the annual proxy statement) with adjustments to the amounts included for pensions and equity awards. See U.S. Securities and Exchange Commission, 'SEC Proposes Rules to Require Companies to Disclose the Relationship Between Executive Pay and a Company's Financial Performance', 29 April 2015, www.sec.gov/news/pressrelease/2015-78.html.

180 US Securities and Exchange Commission, Release No. 34-74835.

181 US Securities and Exchange Commission, Release No. 33-9877; US Securities and Exchange Commission, 'SEC Adopts Rule for Pay Ratio Disclosure', 5 August 2015, www.sec.gov/news/pressrelease/2015-160.html.

182 US Securities and Exchange Commission, Release No. 33-9877.

ii Shareholder engagement and institutional adviser influence

Shareholders continue to remain engaged with executive compensation through say-on-pay (SOP) advisory votes and the approval of both amended and new equity plans, and institutional advisory services are responding to the increased complexity in executive compensation and equity programmes. Although SOP votes are non-binding, public companies are generally concerned for their outcomes, especially because of the potential to influence director elections, and have been responsive to a 'no' or 'against' vote by institutional investor proxy advisers. In 2015, 61 Russell 3000 companies 'failed' SOP votes, which is slightly higher but generally consistent with the number of 'failed' SOP votes in the past three years.[183] Notably, while just 2.8 per cent of companies 'failed' SOP votes, ISS had issued 'against' recommendations on approximately 12 per cent of SOP votes, meaning that only 20 per cent of companies that received 'against' recommendations from ISS failed their SOP vote, which is also consistent with prior years.[184] As of late May 2016, only 13 Russell 3000 companies had failed SOP votes, compared to 14 Russell 3000 companies with failed SOP votes as of mid-May 2015, and 11 per cent of companies have received 'against' recommendations from ISS as of late May 2016, compared to 9 per cent as of mid-May 2015.[185]

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 and subsequent shareholder outreach, 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 votes.[186] As of mid-May 2016, approximately 8 per cent of Russell 3000 companies had failed SOP votes at least once in the five proxy seasons in which the SOP regulations have

183 '2015 Say on Pay Results – End of Year Report', Semler Brossy, 27 January 2016, www.semlerbrossy.com/wp-content/uploads/SBCG-2015-Year-End-Say-on-Pay-Report.pdf. Compare to 2012, 2013 and 2014, in which 57, 57 and 60 (respectively) Russell 3000 companies received 'failed' SOP votes, many after an institutional investor proxy adviser such as Institutional Shareholder Services (ISS) or Glass, Lewis & Co had recommended a 'no' vote. See also 'U.S. Executive Compensation 2015 Recap, Key Developments & Notable Trends', Frederic W Cook & Co, Inc and Simpson Thacher, 31 March 2016, www.fwcook.com/alert_letters /03_31_16_US_Executive_Compensation_2015_ Recap,_ Key_ Developments_&_Notable_Trends.pdf.

184 '2015 Say on Pay Results – End of Year Report', footnote 183; 'U.S. Executive Compensation 2015 Recap, Key Developments & Notable Trends', footnote 183.

185 '2015 Say on Pay Results', Semler Brossy, 4 May 2016, www.semlerbrossy.com/wp-content/uploads/SBCG-2016-SOP-Report-05-04-2016.pdf; '2016 Say on Pay Results – Reasons for Say on Pay Failure', Semler Brossy, 18 May 2016, www.semlerbrossy.com/wp-content/uploads/SBCG-2016-SOP-Report-05-18-2016.pdf; '2015 Say on Pay Results', Semler Brossy, 27 May 2015, www.semlerbrossy.com/wp-content/uploads/SBCG-2015-SOP-Report-2015-05-27.pdf.

186 Ross Brondfield, 'Handling Say-on-pay Aftershocks: How Directors Can Prepare for Elections After a Poor Vote Outcome', Semler Brossy, 17 August 2015, www.semlerbrossy.com/insights/handling-say-on-pay-aftershocks-how-directors-can-prepare-for-elections-after-a-poor-vote-outcome.

been in effect, but only 1.6 per cent of companies had failed SOP more than once.[187] On average, Russell 3000 companies that have failed a SOP vote in a given year, and taken corrective action or conducted shareholder outreach and received a subsequent ISS 'for' vote, have seen a 26 per cent increase in shareholder support for the SOP proposal the following year.[188] 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 500 comprising equity and performance-based incentives.[189]

Given the increasingly complex structures of equity and compensation programmes, a pass/fail review is increasingly unworkable, and data suggest that the influence of ISS and other proxy advisers on investor voting is not absolute. In 2015, ISS issued 'against' recommendations on approximately 12 per cent of SOP proposals, while just 2.8 per cent of companies actually failed SOP votes, meaning that only 20 per cent of companies that received 'against' recommendations from ISS actually failed their SOP vote.[190] In 2015, there were 521 proposed equity plan amendments and 247 proposed equity plans submitted to shareholders, of which ISS opposed approximately 20 per cent; all the amendments and plans passed.[191] However, data does not suggest that ISS recommendations do not carry significant weight; as of May 2016, ISS has recommended 'against' SOP votes at 11 per cent of the companies it assessed, and of completed votes, shareholder support was approximately 28 per cent lower at those companies.[192] In 2015, for the equity plan proposals, an ISS 'against' vote resulted in an average 13 to 14 per cent lower support from shareholders for equity plan proposals.[193] In 2015, ISS developed a 'scorecard' approach to reviewing equity plan proposals, in which ISS reviews a variety of both positive and negative factors, in contrast to

187 '2015 Say on Pay Results – End of Year Report', footnote 183; '2016 Say on Pay Results – Reasons for Say on Pay Failure', footnote 185.

188 '2015 Say on Pay Results – End of Year Report', footnote 183.

189 Becky Huddleston, Erik Nelson, and Robert Newbury, 'Executive Compensation Bulletin', Willis Towers Watson, 19 May 2016, www.towerswatson.com/en-US/Insights/Newsletters/Global/executive-pay-matters/2016/Executive-Compensation-Bulletin-Moderating-growth-in-pay-for-US-CEOs-corporate-performance (note that for smaller cap companies, more than half of compensation is also performance-based, but constitutes slightly lower percentages (69 per cent for S&P 400 companies and 56 per cent for S&P 600 companies); see also 'Total CEO pay in U.S. increased 2.0 per cent in 2015', Willis Towers Watson, 14 April 2016, www.willistowerswatson.com/en/press/2016/04/total-ceo-pay-in-us-increased-2-percent-in-2015.

190 '2015 Say on Pay Results – End of Year Report', footnote 183; 'U.S. Executive Compensation 2015 Recap, Key Developments & Notable Trends', footnote 183.

191 'U.S. Executive Compensation 2015 Recap, Key Developments & Notable Trends', footnote 183.

192 '2016 Say on Pay Results – Reasons for Say on Pay Failure', footnote 185.

193 'U.S. Executive Compensation 2015 Recap, Key Developments & Notable Trends', footnote 183.

their former pass/fail review model.[194] Additionally, many of the major institutional investors, including Blackrock and Vanguard, already maintain in-house proxy analysis and governance groups to inform their own voting decisions in lieu of depending on proxy advisory firms.[195]

iii Golden parachutes and executive severance developments

The SOP regulations have a 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 (CIC) (triggered by most types of M&A transactions). However, certain CIC benefits that historically were 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 as problematic, and are gradually being phased out of practice.[196] ISS's published policy guidance states it is 'likely' to render an 'against' or 'withhold' vote recommendation when single-trigger acceleration or a 280G gross-up is included in a new change-in-control agreement.[197] In addition, ISS now considers legacy excise tax gross-up and single-trigger acceleration provisions in determining its recommendation on SOGP proposals.[198]

Notably, shareholders continue to approve golden parachute provisions; a review of 79 golden parachute votes in 2015 (focused on companies with a market cap over $500 million) found that more than 91 per cent of companies had shareholders vote in favour of golden parachute proposals.[199] However, the level of support varied widely; less than half had 90 per cent approval, one-third had 80 to 90 per cent approval and over

194 '2015 U.S. Equity Plan Scorecard, Institutional Shareholder Services, www.issgovernance.com/file/policy/2015-faq-us-equity-plan-scorecard-030315.pdf; '2016 U.S. Equity Plan Scorecard", ISS, www.issgovernance.com/file/policy/faq-on-iss-us-equity-plan-scorecard-methodology.pdf; 'U.S. Executive Compensation 2015 Recap, Key Developments & Notable Trends', footnote 183.

195 See '2015 proxy voting guidelines for U.S. securities', Blackrock, www.blackrock.com/corporate/en-us/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf; 'Vanguard's proxy voting guidelines', Vanguard, www.about.vanguard.com/vanguard-proxy-voting/voting-guidelines.

196 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 favourable SOGP or SOP vote, and such practices are particularly highlighted in the SOGP disclosure.

197 ISS 2016 US Compensation Policy FAQ, Q&A 57, www.issgovernance.com/file/policy/2016comprehensivecompensationfaqs.pdf.

198 ISS 2016 US Compensation Policy FAQ, Q&A 72, www.issgovernance.com/file/policy/2016comprehensivecompensationfaqs.pdf.

199 'Year-End M&A Flurry Shines a Light on Golden Parachutes', Equilar, 26 December 2015, www.equilar.com/blogs/56-year-end.html.

one-quarter of companies had an approval percentage of less than 80 per cent.[200] Going forward, while golden parachutes will remain a feature of executive compensation, given the range of shareholder responses to SOGP proposals and pressure from proxy advisers to limit excessive compensation package strategies, it is likely that companies will continue to review and restructure such benefits.[201]

iv Shareholder litigation focuses on director compensation

Shareholder litigation in 2015 had a new focus on director compensation, specifically alleging excessive director pay and rejecting equity plan limits on awards as a defence.[202] Previous litigation, following the adoption of the SOP regulations, had focused on SOP votes that achieved less than 70 per cent support. Notably, in response to increased director litigation (and the *Slager* case), many companies have adopted specific director award limits, and one report found that 82 per cent of director-specific awards limits included in company equity plans were established since 2013.[203]

Calma v. Templeton (more commonly referred to as *Citrix*) resulted in a change in black letter law favouring plaintiffs.[204] In *Citrix*, the Delaware Court of Chancery 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 plan, when combined with cash payments, were excessive in comparison to the compensation of similarly situated directors of peer

200 Id.

201 Nelson, 'Executive Compensation Bulletin: The Changing Landscape of Golden Parachutes', footnote 196.

202 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 Court of Chancery 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. See also Alana Griffin, 'Director Compensation in the Spotlight', Director's Center, 17 May 2016, www.directorscenter.com/executive-compensation-succession; Doreen Lilienfeld, 'Director Compensation In The Crosshairs Of The Delaware Courts', 10 December 2015, www.mondaq.com/unitedstates/x/450996/Executive+Remuneration /Director+Compensation+In+The+Crosshairs+Of+The+Delaware+Courts.

203 See *Seinfeld v. Slager*, footnote 202; Michael Bowie, 'Executive Compensation Bulletin', Willis Towers Watson, 28 March 2016, www.towerswatson.com/en-US/Insights/Newsletters/Global/executive-pay-matters/2016/Executive-Compensation-Bulletin-Annual-limits-for-director-stock-awards-gaining-steam.

204 See *Calma v. Templeton*, 114 A3d 563 (Del Ch 30 April 2015). 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.

corporations.[205] In *Espinoza v. Zuckerberg*, shareholders alleged that certain restricted stock unit (RSU) grants to directors were excessive, and that since a majority of board members had received the RSUs grant, the transaction was not disinterested and should be viewed under the 'entire fairness' standard of review.[206] The Delaware Court of Chancery held that informal shareholder ratification of the director compensation decisions was not adequate under Delaware law, and the directors' decision to grant themselves compensation would instead be viewed under the 'entire fairness' standard.[207] The case was settled in early 2016. In *Binning v. Ogunlesi*, shareholders claimed that the decisions of Goldman Sachs directors who approved RSU compensation for themselves, pursuant to a validly approved equity plan but in the absence of a meaningful limit included in the plan, should be held to the 'entire fairness' standard, particularly given that certain company peer directors received significantly less.[208] The case is still pending.

v Looking ahead

The release of additional SEC regulations, combined with consistent trends on SOP votes, SOGP votes, and CIC severance practice and increased shareholder litigation, all indicate that executive and director compensation will increase in visibility and importance. Companies are expected to provide significant information to shareholders and seek shareholder feedback on compensation programme design with greater frequency, and it is not yet clear what the impact the additional SEC regulations will have on compensation arrangements. Given the increased focus on director compensation and the willingness of courts to entertain shareholder litigation in the aftermath of *Citrix*, companies should review their compensation and equity programmes (including those for directors) and carefully document compensation decisions, particularly in the context of acquisitions.

Shareholders are also likely to continue exploring other avenues for influencing the pay practices of unresponsive companies. Thus far, director re-election generally has been affected but not swayed by failed SOP votes, although shareholders increasingly expressed frustration over compensation practices by voting against re-election of directors, particularly those involved in compensation decisions.[209] The practices identified as most troublesome by ISS and other proxy advisory firms will likely continue to disappear, 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 under increasingly complex pay-for-performance programmes. 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

205 Id.

206 See *Espinoza v. Zuckerberg*, 124 A3d 47 (Del Ch 28 October 2015).

207 Id.

208 See *Binning v. Ogunlesi, et al*, CA No. 11118-CB (Del Ch complaint filed 9 June 2015).

209 See Brondfield, 'Handling Say-on-pay Aftershocks', footnote 186; 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.

shareholder engagement, will have on future M&A transactions, but participants should engage with management and boards early in the acquisition process to ensure that adequate thought is given to executive compensation and disclosure.

VIII TAX LAW

Throughout 2015 and the first half of 2016, the Treasury Department continued to create new rules that target tax-driven transactions and established tax-planning strategies. First, the Treasury issued new rules and final and temporary regulations governing 'inversion' transactions. Second, it issued proposed regulations for Section 385 of the Internal Revenue Code to help the IRS combat 'earnings stripping'.

i New rules for inversion transactions—the 'third country rule' and the 'serial inversion rule' ('Pfizer–Allergan rule')

An inversion is a business combination in which a US company becomes a subsidiary of a foreign company. A critical requirement in most inversions is that the shareholders of the US company must own less than 80 per cent of the stock (by vote and value) of the resulting foreign company (the 80 per cent requirement). Normally, this is accomplished by completing a stock-for-stock merger with a foreign company that is at least one-quarter the size of the US company.

To take a simple example, if a US company worth $80 completed a merger with a foreign company worth $20, with the US company's shareholders receiving stock of the foreign company worth $80, the transaction would fail the 80 per cent requirement because the US company's shareholders would own 80/100, or 80 per cent, of the combined company. If, however, the foreign company were instead worth $21, the 80 per cent requirement would be satisfied, because the US company's shareholders would own 80/101, or 79.2 per cent, of the combined company.

If the 80 per cent requirement is not satisfied, the result is that the inversion 'fails'. That is, the foreign company is treated as a US company for all US tax purposes – a catastrophic result from a tax planning perspective.

On 19 November 2015, the Treasury Department announced new rules in Notice 2015-79, which were later incorporated into temporary regulations issued on 4 April 2016. The new rules accomplished two goals. First, they made it more difficult for transactions to satisfy the 80 per cent requirement, and second, they reduced the planning benefits available to inverted companies. The most notable rule in the Notice is the 'third country rule,' which governs structures where a foreign holding company is formed to acquire both the US company and the foreign company.

In this structure, rather than having the foreign company (foreign target) directly acquire the US company (US target), a new foreign parent company (foreign parent) is formed that acquires both the US target and foreign target. Often, the foreign parent has a different tax residence than the foreign target; that is, the foreign parent is a tax resident of a 'third country'. This can be very advantageous for tax purposes, because the third country may have a less restrictive tax regime or a more favourable income tax treaty with the US, the better to implement post-closing planning opportunities with US target.

The third country rule effectively prevents the use of these third-country inversion structures by making it more difficult to satisfy the 80 per cent requirement. When the third country rule applies, it changes the way the 80 per cent requirement is determined: in calculating the percentage under the rule, any shares issued to shareholders of the foreign target are completely disregarded.

The result is drastic. Assume a US target worth $79 and a foreign target worth $21 complete an inversion transaction using new foreign parent, with the US target's shareholders receiving 79 shares of the foreign parent and the foreign target's shareholders receiving 21 shares of the foreign parent. Before the third country rule, there would be no violation of the 80 per cent requirement because US target's shareholders only own 79/100, or 79 per cent, of the stock in foreign parent. However, under the third country rule, if the foreign parent and foreign target have different tax residences, the third country rule disregards the 21 shares held by foreign target's shareholders. This leaves the US target's shareholders with 79/79, or 100 per cent, of the foreign parent's stock and the foreign target's shareholders with zero/79, or zero per cent, of the foreign parent's stock. The 80 per cent requirement is not satisfied, and the inversion fails.

There are two advanced points to note about the third country rule. First, a foreign target cannot avoid the third country rule by simply changing its tax residence to the foreign parent's country before the inversion. A special rule prevents this kind of structuring to avoid the rule. Second, the third country rule does not apply when a US target's shareholders would otherwise own less than 60 per cent of the foreign parent's stock after the transaction. For example, where a US target worth $50 and a foreign target worth $50 sought to complete an inversion transaction, a new foreign parent could be used with a tax residency that differs from the foreign target's. The rationale behind this rule seems to be that such a transaction is far less likely to be motivated by tax considerations than a transaction where a US company worth $79 seeks a transaction with a foreign target worth $21, and therefore the drastic consequences of the third country rule are not necessary as a tool to combat tax-motivated transactions.

One consequence of the third country rule is that it made foreign companies in 'desirable' foreign jurisdictions (e.g., the United Kingdom, Ireland or the Netherlands – desirable, perhaps, for their local tax features or for their favourable tax treaties with the US, or both) more attractive as possible inversion targets than foreign companies in other jurisdictions. And because foreign companies must be at least one-quarter the size of US companies to be attractive inversion targets in the first place, it has long been the case that the larger the foreign company, the more likely it is to be an inversion target. Those two concepts, put together, produced an ironic and likely unintended result: at the time the third country rule was announced, some very large UK, Irish or Dutch companies were themselves the products of inversion transactions in the preceding few years. So these 'foreign' companies, a significant portion of the value of which was comprised of US companies acquired in inversions, became vehicles through which US companies could complete ever-larger inversions.

The best example of this phenomenon is Allergan plc, today an Irish company but itself the product of many prior inversions. In 2013, a US company called Actavis, Inc, completed an inversion transaction with an Irish company called Warner Chilcott plc and was renamed Actavis plc. In 2014, Actavis plc was the foreign company in an inversion of a US company named Forest Laboratories, Inc, which became a subsidiary of Actavis plc. In 2015, Actavis plc was once again the foreign company in an inversion of a US company, this time Allergan, Inc After the Allergan acquisition, Actavis plc renamed itself 'Allergan plc'. At the time of Notice 2015-79, Allergan plc was a large foreign company with a market capitalisation of over $119 billion.

During this time, a large US company, Pfizer, made no secret of its desire to complete an inversion. In 2014, it had sought to convince UK-based AstraZeneca to merge, but AstraZeneca fended off Pfizer's overtures. With a market cap of around $200 billion, Pfizer no doubt found that identifying a foreign merger partner of the necessary size to satisfy the 80 per cent requirement was not an easy task.

Enter Allergan plc, which, as noted above, had a market capitalisation exceeding $119 billion in November 2015. It was exactly what Pfizer wanted. Four days after Notice 2015-79 was issued, Pfizer and Allergan announced that they had agreed to merge in an inversion transaction. In a press release, the companies announced that Pfizer's shareholders and Allergan's shareholders would own approximately 56 per cent and 44 per cent, respectively, of the combined company. In other words, the 80 per cent requirement would be satisfied easily.

The Treasury Department put the Pfizer/Allergan deal squarely in its crosshairs. On 4 April 2016, the Treasury Department issued inversion regulations that set forth new rules that continue the trend of impeding inversions and reducing their tax benefits. The most significant of these is the 'serial inversion rule', which makes it difficult for foreign corporations to participate in inversions if they have acquired US companies in the past three years.

The serial inversion rule prevents corporations from using these earlier acquisitions of US targets to 'bulk up' and bypass the inversion ownership requirements. The rule operates by excluding from the percentage calculation any shares issued to shareholders of US targets in the three years prior to the inversion in question. As noted above, prior to the serial inversion rule, the Pfizer/Allergan inversion would have easily satisfied the 80 per cent requirement. However, the serial inversion rule changed the calculation substantially. Under the rule, all of the shares issued to shareholders of Actavis, Forest Laboratories and Allergan in those earlier transactions would be excluded. The result would be to increase sharply the percentage of the combined company that Pfizer shareholders would be treated as owning. Journalists' calculations suggested that Pfizer shareholders would be treated as owning about 87 per cent of the combined Pfizer/Allergan entity, clearly failing the 80 per cent requirement. It was not a surprise when, only two days after the serial inversion rule was announced, Pfizer and Allergan abandoned their deal, citing 'adverse tax law change'.[210] For this reason, the serial inversion rule has become known in some circles as the 'Pfizer/Allergan Rule'.

(It is important to note that Treasury officials have denied targeting any specific transaction with the serial inversion rule, notwithstanding the sense of most practitioners that no other announced transaction was affected by the serial inversion rule.)

The serial inversion rule applies without regard to a foreign company's intent in acquiring US companies. Whether the foreign company planned to become an inversion target, or whether the US target acquisitions falling within the three-year span were even related, is irrelevant. All that matters is that one or more US targets were acquired in the past three years and that stock was issued to shareholders of any US target. (There is an exception that applies in cases where US targets smaller than $50 million are acquired and comprise less than 5 per cent of the value of the foreign company, but those cases will be rare.)

210 Press release, Pfizer, 'Pfizer Announces Termination of Proposed Combination with Allergan', 6 April 2016, www.pfizer.com/news/press-release/press-release-detail/pfizer_announces_termination_of_proposed_combination_with_allergan.

ii Section 385 regulations limiting 'earnings stripping'

On the same day that the Treasury Department issued the newest inversion regulations, it also issued proposed regulations targeting 'earnings stripping'. 'Earnings stripping' refers to the practice of establishing intercompany debt from a US company to a foreign affiliate; the interest is deductible in the US at a 35 per cent rate and normally includible in the affiliate's income at a much lower rate. This has the effect of shifting income out of the US and into lower-tax foreign jurisdictions. With the wave of inversions in recent years, earnings stripping has become a particularly common tool for tax planning, but earnings stripping has long been available, subject to certain limitations, for all multinational companies with US subsidiaries. Indeed, the proposed regulations are aimed at earnings stripping structures generally, not only those established through inversions.

The proposed regulations were issued under Section 385 of the US Tax Code. Section 385 was enacted in 1969 and gives the Treasury Department broad authority to recharacterise debt as equity for US tax purposes. This regulatory authority was used once before, in 1980, when the Treasury Department issued final regulations; those regulations had a delayed effective date that was extended many times. In the end, the regulations were withdrawn in 1983 without ever having come into effect.

This year's proposed regulations establish three important rules with respect to intercompany debt, all aimed at recharacterising debt, in whole or in part as equity. (Recharacterising debt as equity has many consequences. 'Interest' payments are no longer deductible because they are instead treated as dividends on the equity. Moreover, those dividends will be subject to US withholding tax.) First, taxpayers must comply with substantial documentation requirements for their intercompany debt or risk recharacterisation of the debt as equity. These requirements are intended to help the IRS determine whether the issuer could reasonably be expected to repay the debt – a key indicator of debt status. Satisfaction of the documentation requirements is a necessary requirement, but not a sufficient one – intercompany debt that is properly documented can still be recharacterised as equity.

Second, the IRS can treat intercompany debt as in part equity and in part debt. This is a change from the current law, where any given instrument is either entirely equity or entirely debt. The change stems from the Treasury's belief that a binary approach to debt-equity analysis 'frequently fails to reflect the economic substance of related-party interests that are in form indebtedness and gives rise to inappropriate federal tax consequences'.[211]

Third, and most importantly, the IRS will recharacterise intercompany debt as equity when it is issued in a distribution or in an acquisition in exchange for related party stock or in exchange for property in an asset reorganisation, unless an exception applies. This is particularly problematic for taxpayers because of a special rule in the proposed regulations called the 'funding rule,' which treats as equity any intercompany debt issued with a 'principal purpose' of funding such a distribution or acquisition. Moreover, if any company issuing intercompany debt has engaged in such a distribution or acquisition within 36 months before the issuance, or so engages within 36 months after the issuance, the issuance is deemed to have had such a prohibited purpose.

The funding rule is both important and controversial. In essence, it creates a six-year window around any intercompany debt issuance during which the issuer's actual 'principal

211 Department of the Treasury, 'Treatment of Certain Interests in Corporations as Stock or Indebtedness', REG-108060-15.

purpose' does not matter: if a distribution or acquisition occurs during that window, the debt issuance will be recharacterised as equity. Therefore, diligence and monitoring are critical. Before intercompany debt is put into place, the prior three years must be reviewed to determine whether a distribution or acquisition has occurred. In addition, after the intercompany debt is put into place, the subsequent three years must be monitored to ensure that such a distribution or acquisition does not occur.

One important exception to the funding rule is that distributions of current year 'earnings and profits' do not count as 'distributions'. This exception is likely to encourage strategic taxpayers to distribute intercompany debt in amounts up to each year's earnings and profits; doing so will insulate that intercompany debt from the risk of being recharacterised under the funding rule. Note, however, that using this exception requires some ability to estimate reliably earnings and profits for any then-current year. This is not always easy or practicable.

Taxpayers should note that the recharacterisation rules in the proposed regulations can be used only by the IRS against taxpayers. Taxpayers cannot rely on these regulations to affirmatively treat debt as equity as part of their tax-planning strategies.

The Treasury's aggressive position in issuing these Section 385 proposed regulations surprised many corporate taxpayers and tax advisers. While the Treasury previously warned taxpayers that new earnings stripping rules were being considered, few in the tax community anticipated the issuance of earnings stripping rules with such broad scope. The proposed regulations have prompted concern from the legal and business community, with some arguing that the Treasury does not have authority to create such rules and others asserting that these policies will deter investment in the US. While the Treasury has indicated some marginal flexibility, it has announced that it expects to finalise the regulations 'swiftly'. Once the regulations are finalised, they will generally apply to purported debt instruments issued on or after 4 April 2016.[212]

iii Conclusion

It is clear that the Treasury intends to dramatically reduce US companies' opportunities to avoid US taxes through tax planning and tax-driven transactions. The Treasury's announcements over the course of the past year demonstrate that it is willing to adopt aggressive policies in order to preserve the US tax base. While corporate taxpayers and their advisers will surely continue to engage in sophisticated tax planning, these new Treasury rules and regulations will shift dealmakers away from tax-driven transactions and towards transactions that have fundamental business rationales.

IX COMPETITION LAW

In the past year, the Antitrust Division of the Department of Justice (DoJ) and the FTC (together with the DoJ, 'agencies') have continued to carefully examine potential anticompetitive effects of transactions involving a wide array of industries, including retail and consumer goods, manufacturing, healthcare, newspapers, technology and energy, and

212 Elizabeth Boone, 'Controversy Amid Unveiling of Proposed Earnings Stripping Regulations', Bloomberg BNA Federal Tax Blog, 28 April 2016, www.bna.com/controversy-amid-unveiling-b57982070420.

have successfully litigated several high-profile merger challenges. Both agencies have made headlines with successful challenges to mega-deals involving concentrated markets that resulted in the parties abandoning their proposed transactions, triggering payments of sizeable break-up fees.[213] The past year also saw the FTC being handed two rare losses to merger challenges in federal court, both involving the healthcare sector, where the FTC has remained active in the face of increasing consolidation.[214] Among its recent litigation victories, the FTC prevailed in its lawsuit to preliminarily enjoin the proposed merger between Sysco Corporation (Sysco) and US Foods, which was discussed in (but not decided by the time of) the previous edition of this publication.[215]

The agencies' recent enforcement actions reveal common themes. Both the DoJ and the FTC have convinced courts to reject attempts by merging parties to expand traditional relevant markets, such as print newspapers and bricks-and-mortar retail, to include internet-based competition.[216] The agencies have also successfully challenged deals on theories of anticompetitive harm to large businesses purchasing through high-volume contracts.[217] The agencies have also continued to show a willingness to litigate where the merging parties propose to fix competitive issues through divestitures that the agencies deem inadequate to restore pre-merger competition.[218]

In 2015, the FTC brought 21 merger actions in second request or compulsory process investigations.[219] In 2015, the DoJ initiated 10 merger challenges in federal court, with nine resulting in the parties agreeing to divestitures or other remedies via consent decrees, and one resulting in the parties abandoning the deal after entry of a preliminary injunction. The DoJ has initiated another three merger challenges year-to-date 2016, with one resulting in the

213 See press release, Department of Justice, 'Halliburton and Baker Hughes Abandon Merger After Department of Justice Sued to Block Deal', 1 May 2016, www.justice.gov/opa/pr/halliburton-and-baker-hughes-abandon-merger-after-department-justice-sued-block-deal; press release, Federal Trade Commission, 'After Staples and Office Depot Abandon Merger FTC Dismisses Case from Administrative Trial Process', 19 May 2016, www.ftc.gov/news-events/press-releases/2016/05/after-staples-office-depot-abandon-proposed-merger-ftc-dismisses.

214 See *FTC v. Steris*, 133 F Supp 3d 962 (ND Oh 2015); *FTC v. Penn State Hershey Med Ctr*, No. 15-2362 (MDPa 9 May 2016).

215 *FTC v. Sysco Corp*, 113 F Supp 3d 1 (DDC 2015).

216 See *FTC v. Staples*, No. 15-2115 (DDC 21 January 2016); *US v. Tribune Publishing Co*, No. 16-01822 (CD Cal 18 March 2016).

217 See *Sysco Corp*, 113 F Supp 3d at 55; *FTC v. Staples*, No. 15-2115 (DDC 21 January 2016); see also press release, Department of Justice, 'Electrolux and General Electric Abandon Anticompetitive Appliance Transaction After Four-Week Trial', 7 December 2015, www.justice.gov/opa/pr/electrolux-and-general-electric-abandon-anticompetitive-appliance-transaction-after-four-week.

218 See *Sysco Corp*, 113 F Supp 3d at 56; press release, Department of Justice, 'Justice Department Sues to Block Halliburton's Acquisition of Baker Hughes', 6 April 2016, www.justice.gov/opa/pr/justice-department-sues-block-halliburton-s-acquisition-baker-hughes.

219 See Federal Trade Commission Fiscal Year 2015 Performance Report and Annual Performance Plan for Fiscal Years 2016 and 2017, www.ftc.gov/system/files/documents/reports/fy-2016-2017-performance-plan-fy-2015-performance-report/pprfy16-17_0.pdf.

parties agreeing to divestitures via consent decree, one resulting in the parties abandoning the deal shortly after the complaint was filed, and one resulting in the acquisition being blocked by a temporary restraining order.[220]

In February 2016, 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 $78.2 million (increased from $76.3 million).[221] In terms of personnel changes since the previous edition of the publication, Ginger Jin was named director of the FTC's Bureau of Economics, Julie Brill and Joshua Wright have resigned as FTC commissioners, and Renata Hesse has replaced William Baer as the head of the DoJ Antitrust Division.[222]

i DoJ

Halliburton/Baker Hughes

In November 2014, Halliburton Co (Halliburton) and Baker Hughes Inc (Baker Hughes), the world's second and third-largest oilfield services companies (behind Schlumberger Limited), announced an agreement for Halliburton to acquire Baker Hughes in a cash-and-stock deal valued at $34.6 billion at the time of announcement.[223] From the outset, it was clear that the proposed merger would raise significant antitrust concerns in a number of product and service areas, given the extensive overlap between the parties' portfolios and the concentrated nature of the oilfield services industry. Halliburton, however, made clear that it viewed these hurdles as surmountable, and the parties initially anticipated that, with a proactive approach to divestitures and active engagement with the DoJ and other antitrust authorities reviewing the deal, they could obtain the necessary antitrust approvals by the second half of 2015.[224]

220 Department of Justice, Antitrust Case Filings, www.justice.gov/atr/antitrust-case-filings.

221 See 'FTC Announces New Clayton Act Monetary Thresholds for 2016', Federal Trade Commission, www.ftc.gov/news-events/press-releases/2016/01/ftc-announces-new-clayton-act-monetary-thresholds-2016.

222 See press release, Federal Trade Commission, 'Ginger Jin Named Director of FTC's Bureau of Economics; Alison Oldale Named BE Deputy Director for Antitrust', 24 November 2015, www.ftc.gov/news-events/press-releases/2015/11/ginger-jin-named-director-ftcs-bureau-economics-alison-oldale; press release, Federal Trade Commission, 'FTC Commissioner Julie Brill to Resign', 22 March 2016, www.ftc.gov/news-events/press-releases/2016/03/ftc-commissioner-julie-brill-resign; press release, Federal Trade Commission, 'FTC Commissioner Joshua D. Wright to Resign', 17 April 2015, www.ftc.gov/news-events/press-releases/2015/08/ftc-commissioner-joshua-d-wright-resign; press release, Department of Justice, 'Attorney General Loretta E. Lynch Announces Renata B. Hesse to Serve as Head of Antitrust Division', 15 April 2016, www.justice.gov/opa/pr/attorney-general-loretta-e-lynch-announces-renata-b-hesse-serve-head-antitrust-division.

223 See Michael J De La Merced, 'Halliburton and Baker Hughes Agree to Friendly $34.6 Billion Merger', *New York Times*, 17 November 2014, dealbook.nytimes.com/2014/11/17/halliburton-to-buy-baker-hughes-for-34-billion/?_r=0.

224 See press release, Halliburton, 'Halliburton and Baker Hughes announce approval of transaction by stockholders of both companies', 27 March 2015, www.halliburton.com/public/news/pubsdata/press_release/2015/halliburton-and-baker-hughes-announce-approval-of-transaction-by-stockholders-of-both-companies.html.

The parties' expectations, however, proved unrealistic. Although, early in the process, Halliburton committed to divest billions of dollars' worth of assets in certain overlap areas, and had already started lining up divestiture buyers, its proactive commitments were not enough to assuage the DoJ's concerns about the transaction. In July 2015, the parties entered a timing agreement, which extended the time for the DoJ to complete its review of the deal to 25 November 2015 or 90 days after both companies certified substantial compliance with the second request.[225] A number of extensions, and additional divestiture commitments, followed.[226] In December 2015, with the DoJ signalling to the parties that their remedial proposals remained inadequate to resolve its concerns, the parties agreed to further extend the outside date for obtaining the required antitrust approvals to 30 April 2016, and the next month Halliburton indicated that it would be adding additional assets to its divestiture proposal.[227]

Ultimately, the parties' proactive efforts proved unavailing. On 6 April 2016, the DOJ sued to block the merger, alleging that it would reduce competition in 'at least 23 oilfield products and services critical to the nation's energy supply', notwithstanding the proposed divestitures, which, according to the DoJ, were inadequate because they 'did not include full business units, withheld many critical assets and personnel, involved numerous ongoing entanglements between the merged company and the divestiture buyer and generally failed to replicate the robust competition between the parties that exists today'.[228] Although by that point Halliburton had committed to an 'enhanced' divestiture package, it was unlikely that any amount of divestitures would alleviate the DoJ's concerns. According to David Gelfand, the number two lawyer at the Antitrust Division, the merger simply 'was not fixable', as 'the anticompetitive effects spread across so much of the business there was no way to divest individual free-standing businesses without divesting the entire company'.[229] Bill Baer, the head of the Antitrust Division at the time, described the merger as falling 'squarely' in the category of deals that should never have left the corporate boardroom.[230]

225 See press release, Halliburton, 'Halliburton and Baker Hughes Provide Update on Proposed Acquisition', 10 July 2015, www.halliburton.com/public/news/pubsdata/press_release/2015/halliburton-and-baker-hughes-provide-update-on-proposed-acquisition.html.

226 See press release, Halliburton, 'Halliburton and Baker Hughes Announce Additional Divestiture Proposals', 28 September 2015, www.halliburton.com/public/news/pubsdata/press_release/2015/Halliburton-BakerHughes-announce-additional-divestiture.html.

227 See press release, Halliburton, 'Halliburton and Baker Hughes Provide Update Regarding DOJ review', 15 December 2015, www.halliburton.com/public/news/pubsdata/press_release/2015/baker-hughes-update.html.

228 See press release, Department of Justice, 'Halliburton and Baker Hughes Abandon Merger After Department of Justice Sued to Block Deal', 1 May 2016, www.justice.gov/opa/pr/halliburton-and-baker-hughes-abandon-merger-after-department-justice-sued-block-deal.

229 See David McLaughlin, 'Halliburton's 'Unfixable' Deal Succumbed to Global Pushback (2)', *The Washington Post*, 2 May 2016, washpost.bloomberg.com/Story?docId=1376-O6JIK46S972B01-6L24LUHVRKRE61J1G3BT0MCND8.

230 See Brent Kendall and Alison Sider, 'Justice Department Files Lawsuit Challenging Halliburton-Baker Hughes Deal', *The Wall Street Journal*, 6 May 2016, www.wsj.com/articles/justice-department-files-lawsuit-challenging-halliburton-baker-hughes-deal-1459952507.

Although the parties initially vowed to fight the lawsuit, on 1 May 2016, with the expiration of the extended outside date, the parties decided to abandon the deal, triggering a $3.5 billion break-up fee owed by Halliburton to Baker Hughes.[231] Discussing the parties' decision, Mr Gelfand indicated that the failed merger should serve as a lesson to companies contemplating large-scale deals in concentrated industries, noting: '[i]f parties want to sort of roll the dice and see if they can convince us, that's their prerogative; that's their legal right, but they should understand we are ready to litigate these cases.'[232]

ii FTC

Staples/Office Depot

As discussed in the previous edition of this publication and in Section I, *supra*, in February 2015, the FTC sued to block the proposed merger of Sysco and US Foods on a theory of harm in a market for broadline, nationwide food service distribution services serving large food retailers. On 23 June 2015, the district court hearing the FTC's challenge agreed, and granted the FTC's motion to preliminarily enjoin the merger, which Sysco and US Foods decided to abandon shortly after the adverse ruling.[233] Following closely on the heels of its victory in *Sysco/US Foods*, the FTC again went to court to enjoin a merger on a theory of harm in a discrete market for nationwide products and services servicing large business customers. In December 2015, the FTC sued to prevent Staples, Inc (Staples) from acquiring its rival office supply retailer Office Depot, Inc (Office Depot), arguing that the result of the tie-up would be a merger to monopoly in markets for contracts with large businesses requiring sophisticated office-supply services with nationwide delivery capabilities.[234] At the time of its announcement in February 2015, it was anticipated that the proposed $6.3 billion deal would face significant antitrust scrutiny; the parties believed, however, that the rise of hyper-competitive e-retailers such as Amazon, and mass merchandisers such as Wal-Mart and Target, should convince the FTC that competition for office supplies would remain intense following the acquisition.[235]

By the time it completed its nearly year-long investigation, however, the FTC remained unconvinced, and filed suit. The FTC's preliminary injunction motion was litigated in the District of Columbia federal district court in a trial lasting nearly three weeks. The trial focused in large part on the competitive significance of Amazon's emerging business-to-business office

231 See David McLaughlin, 'Halliburton's 'Unfixable' Deal Succumbed to Global Pushback (2)', *The Washington Post*, 2 May 2016, washpost.bloomberg.com/Story?docId=1376-O6JIK46S972B01-6L24LUHVRKRE61J1G3BT0MCND8.

232 Id.

233 *FTC v. Sysco Corp*, 113 F Supp 3d 1 (DDC 2015); press release, Federal Trade Commission, 'Following Sysco's Abandonment of Proposed Merger with US Foods, FTC Closes Case', 1 July 2015, www.ftc.gov/news-events/press-releases/2015/07/following-syscos-abandonment-proposed-merger-us-foods-ftc-closes.

234 See press release, Federal Trade Commission, 'FTC Challenges Proposed Merger of Staples, Inc and Office Depot, Inc', 7 December 2015, www.ftc.gov/news-events/press-releases/2015/12/ftc-challenges-proposed-merger-staples-inc-office-depot-Inc.

235 See Michael J De La Merced and David Gelles, 'Staples and Office Depot Say a Merger Will Keep Them Competitive', *New York Times*, 4 February 2016, dealbook.nytimes.com/2015/02/04/staples-to-buy-office-depot-for-6-3-billion.

supply venture, with Office Depot and Staples characterising Amazon as a substantial threat that would replace any competition lost by the merger, and the FTC and its economist contending that Amazon was unlikely to make a significant dent in the market for large corporate customers to blunt the market power of the merged companies.[236] As the trial progressed, it was not obvious that the FTC would prevail. The judge hearing the motion was strikingly critical of the FTC's handling of one of its key witnesses, the Vice President of Amazon's business-to-business office supply unit, indicating that the FTC tried to persuade the witness 'to say something for the benefit of the United States of America that is not true', and characterising the FTC's efforts as 'very disturbing'.[237] In addition, at the conclusion of the FTC's case, the defence rested without presenting any of its own evidence or expert testimony, arguing that the FTC failed to establish its *prima facie* case.[238]

Despite the FTC's apparent setbacks at trial, on 10 May 2016, the court ruled in its favour, issuing an order to preliminarily enjoin the merger.[239] In its ruling, the court found that there is a distinct market for large business-to-business customers purchasing significant volumes of office consumables, who need sophisticated IT capabilities, personalised service and expedited nationwide delivery capabilities that Staples and Office Depot are uniquely capable of supplying.[240] The court also agreed with the FTC that 'the evidence presented during the hearing fell short of establishing that Amazon Business is likely to restore lost competition in the B-to-B space in a timely and sufficient manner'.[241] Following entry of the court's order, the parties announced that they would abandon the deal, with Staples paying Office Depot a $250 million break-up fee. [242]

Steris Corp/Synergy Health

On 24 September 2015, in *FTC v. Steris*, the District Court for the Northern District of Ohio handed the FTC a rare loss in a merger challenge.[243] The ruling followed a three-day hearing focused on whether the target, Synergy Health plc (Synergy), had abandoned plans to build X-ray sterilisation plants in the US that would compete with the gamma radiation business of the acquirer, Steris Corp (Steris), as a result of the parties' merger plans. The case involved a rarely-litigated theory of competitive harm known as the actual potential entrant theory. Under this theory, the harm from a merger flows from the fact that, but for the deal, one of the merging parties likely would have entered the relevant market in which the other competes (this theory is sometimes distinguished from another theory involving potential

236 See Andrew M Harris and David McLaughlin, 'Amazon Isn't Threat to Staples-Office Depot, Economist Says', *Bloomberg*, 1 April 2016, www.bloomberg.com/news/articles/2016-04-01/staples-judge-deals-setback-to-ftc-by-excluding-amazon-evidence.

237 See Andrew M Harris and David McLaughlin, 'Staples Judge Slams FTC on Amazon Testimony in Merger Case', *Bloomberg*, 23 March 2016, www.bloomberg.com/news/articles/2016-03-23/staples-judge-slams-ftc-for-false-testimony-in-office-depot-case.

238 See *FTC v. Staples*, No. 15-2115 (DDC 21 January 2016).

239 Id.

240 Id.

241 Id.

242 See Diane Bartze, 'Staples, Office Depot to scrap merger deal after judge rules for FTC, Reuters, 10 May 2016, www.reuters.com/article/us-officedepot-m-a-staples-idUSKCN0Y12SF.

243 See *FTC v. Steris*, 133 F Supp 3d 962 (ND Oh 2015).

market entry, the 'perceived potential competition' theory, which posits that the perceived threat of potential entry into the relevant market itself disciplines the competitive behaviour of firms already in the market).[244]

Steris and Synergy both provide contract sterilisation services of healthcare products, and, at the time, represented the second and third-largest sterilisation companies in the world.[245] While sterilisation can be accomplished through gamma, X-ray or e-beam methods, gamma radiation was the only form of sterilisation available in the US at the time of the announced merger. Synergy, a UK company, had been in the process of implementing a strategy whereby it would open new plants in the US to provide X-ray sterilisation services as an alternative to the gamma sterilisation currently available. However, after the merger was announced, Synergy abandoned its plans to bring X-ray sterilisation to the US. The FTC, alleging that, but for the merger agreement, Synergy would have entered the market in the US to compete head to head with Steris, initiated an administrative complaint challenging the deal, followed by a motion in district court to preliminarily enjoin the deal.[246] According to the complaint, 'the challenged acquisition would eliminate likely future competition between Steris's gamma sterilisation facilities and Synergy's planned x-ray sterilisation facilities in the United States, thus depriving customers of an alternative sterilisation service'.[247]

At the hearing on the FTC's preliminary injunction motion, the defendants argued that Synergy's decision to abandon plans to build the US sterilisation plants was based on Synergy's judgment of the economic viability of successful entry, and had nothing to do with the merger. After a fact-intensive hearing, the court agreed, identifying a number of factors that, according to the court, backed Synergy's explanation for abandoning its plans, including that Synergy's board had never approved the US entry project, that Synergy continued working on the project even after the merger was announced and that the planned entry faced a number of significant economic obstacles.[248] The court noted that '[i]f Synergy had terminated the US x-ray project when it entered talks with Steris, or when the merger was announced [...] the Court might view this scenario differently'.[249]

On 24 September 2015, the court denied the FTC's motion for a preliminary injunction, and the FTC subsequently dropped its administrative challenge to the merger.

244 See generally US Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (2010), Section 5.1, www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

245 See Complaint at 1, *In the Matter of Steris Corp/Synergy Health PLC*, No. 9365 (FTC 29 May 2015).

246 See press release, Federal Trade Commission, 'FTC Challenges Merger of Companies that Provide Sterilization Services to Manufacturers', 29 May 2015, www.ftc.gov/news-events/press-releases/2015/05/ftc-challenges-merger-companies-provide-sterilization-services.

247 See Case Summary, *In the Matter of Steris Corp./Synergy Health PLC*, No. 9365, 7 October 2015, www.ftc.gov/enforcement/cases-proceedings/151-0032/sterissynergy-health-matter.

248 See Steris, 133 F Supp 3d 970-75.

249 Id. at 984.

In a statement following the loss, the FTC continued to express 'competitive concerns about [the] acquisition', but stated that it viewed continued adjudication as against the public interest. [250] On 2 November 2015, Steris announced that it closed the merger.[251]

iii Conclusion

Parties contemplating mega-deals in concentrated industries should take note of the agencies' recent enforcement history. As recent merger challenges make clear, even a willingness to divest significant assets may not be enough to secure approval of a deal with significant and complex overlaps. Although *Steris* demonstrates that it is possible to litigate and win, the vast majority of merger challenges go in the agencies' favour, with the agencies adding a number of impressive victories to their win column in the last several months.

X OUTLOOK

M&A rose to pre-crisis levels in 2015, with mega-deals stealing the market, and acquirers using inexpensive credit, increased corporate funds, finite private equity capital reserves and healthy equity markets. It seemed confidence was back, and actors in large sectors such as healthcare, high technology, and energy and power reached for more activity and bigger companies. However, the credit markets took a hit towards the end of 2015, and the equity markets showed extreme volatility in the first quarter of 2016, slowing the pace of M&A in the US and globally. Moreover, the government has been taking notice of large deals, whether for antitrust, tax, financial regulation or national security concerns, also dampening M&A activity. Regulation has affected the viability of certain deals, and has raised concerns about the regulatory environment to come.

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250 See Statement of the Commission, *In the Matter of Steris Corp/Synergy Health PLC*, No. 9365 (30 October 2015).

251 Brad Perriello, 'Steris closes $2B Synergy Health merger', MassDevice, 2 November 2015, www.massdevice.com/steris-closes-2b-synergy-health-merger.