The Mergers & Acquisitions Review

Eighth Edition

Editor
Mark Zerdin

Law Business Research

The Mergers & Acquisitions Review

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CONTENTS

Editor's Preface xiii
Mark Zerdin

Chapter 1 EUROPEAN OVERVIEW 1
Mark Zerdin

Chapter 2 EUROPEAN COMPETITION 13
Götz Drauz and Michael Rosenthal

Chapter 3 EUROPEAN PRIVATE EQUITY 20
Thomas Sacher, Steffen Schniepp and Guido Ruegenberg

Chapter 4 US ANTITRUST 33
Scott A Sher, Christopher A Williams and Bradley T Tennis

Chapter 5 CROSS-BORDER EMPLOYMENT ASPECTS OF INTERNATIONAL M&A 51
Marjorie Culver, Darren Gardner, Ming Henderson, Dominic Hodson and Peter Talibart

Chapter 6 AUSTRALIA 64
Lee Horan and Greg Golding

Chapter 7 AUSTRIA 79
Christian Herbst

Chapter 8 BAHRAIN 91
Haifa Khunji and Maryia Abdul Rahman

Chapter 9 BELGIUM 106
Olivier Clevenbergh, Gisèle Rosselle and Carl-Philip de Villegas

Chapter 10 BRAZIL.......117
Fernando Alves Meira and Gustavo Paiva Cercilli Crêdo

Chapter 11 BRITISH VIRGIN ISLANDS.......128
Jacqueline Daley-Aspinall and Murray Roberts

Chapter 12 CANADA.......144
Robert Yalden and Emmanuel Pressman

Chapter 13 CAYMAN ISLANDS.......160
Marco Martins

Chapter 14 CHINA.......177
Fred Chang, Wang Xiaoxiao and Huang Jiansi

Chapter 15 COLOMBIA.......191
Sergio Michelsen Jaramillo

Chapter 16 COSTA RICA.......207
John Aguilar Jr and Alvaro Quesada

Chapter 17 CYPRUS.......217
Nancy Ch Erotocritou

Chapter 18 CZECH REPUBLIC.......224
Lukáš Ševčík, Jitka Logesová and Bohdana Pražská

Chapter 19 DOMINICAN REPUBLIC.......233
María Esther Fernández A de Pou,
Mónica Villafaña Aquino and Laura Fernández-Peix Perez

Chapter 20 ECUADOR.......243
Diego Pérez-Ordóñez

Chapter 21 ESTONIA.......253
Sven Papp and Karl-Erich Trisberg

Chapter 22 FINLAND......266
Jan Ollila, Anders Carlberg and Wilhelm Eklund

Chapter 23 FRANCE......277
Didier Martin and Raphaël Darmon

Chapter 24 GERMANY......292
Heinrich Knepper

Chapter 25 GIBRALTAR......304
Steven Caetano

Chapter 26 GREECE......317
Cleomenis G Yannikas, Sophia K Grigoriadou and Anna S Damilaki

Chapter 27 GUATEMALA......330
Jorge Luis Arenales de la Roca and Luis Pedro Del Valle

Chapter 28 HONG KONG......338
Jason Webber

Chapter 29 HUNGARY......347
Levente Szabó and Réka Vízi-Magyarosi

Chapter 30 ICELAND......363
Hans Henning Hoff

Chapter 31 INDIA......371
Justin Bharucha

Chapter 32 INDONESIA......390
Yozua Makes

Chapter 33 IRELAND......404
Éanna Mellett and Robert Dickson

Chapter 34 ISRAEL ... 413
Clifford Davis and Keith Shaw

Chapter 35 ITALY ... 424
Maurizio Delfino

Chapter 36 JAPAN ... 437
Hiroki Kodate and Junya Ishii

Chapter 37 KENYA ... 447
Joyce Karanja-Ng'ang'a and Felicia Solomon Ndale

Chapter 38 KOREA ... 458
Jong Koo Park, Bo Yong Ahn, Sung Uk Park and Young Min Lee

Chapter 39 LITHUANIA ... 473
Giedrius Kolesnikovas and Michail Parchimovič

Chapter 40 LUXEMBOURG ... 479
Marie-Béatrice Noble and Stéphanie Antoine

Chapter 41 MALAYSIA ... 493
Janet Looi Lai Heng and Fariz Abdul Aziz

Chapter 42 MALTA ... 505
Jean C Farrugia and Bradley Gatt

Chapter 43 MAURITIUS ... 515
Muhammad Reza Cassam Uteem and Basheema Farreedun

Chapter 44 MEXICO ... 525
Aarón Levet V and Isaac Zatarain V

Chapter 45 MONTENEGRO ... 534
Slaven Moravčević and Nikola Babić

Chapter 46 MYANMAR......544
Krishna Ramachandra and Benjamin Kheng

Chapter 47 NETHERLANDS......554
Carlos Pita Cao and François Koppenol

Chapter 48 NIGERIA......566
Lawrence Fubara Anga

Chapter 49 NORWAY......571
Ole K Aabø-Evensen

Chapter 50 PANAMA......608
Julianne Canavaggio

Chapter 51 PERU......618
Emil Ruppert and Sergio Amiel

Chapter 52 PHILIPPINES......628
Rafael A Morales, Philbert E Varona, Hiyasmin H Lapitan and Catherine D Dela Rosa

Chapter 53 POLAND......637
Paweł Grabowski, Rafał Celej and Agata Sokołowska

Chapter 54 PORTUGAL......650
Martim Morgado and João Galvão

Chapter 55 ROMANIA......662
Andreea Hulub, Alexandra Niculae and Vlad Ambrozie

Chapter 56 RUSSIA......677
Scott Senecal, Yulia Solomakhina, Polina Tulupova, Yury Babichev and Alexander Mandzhiev

Chapter 57 SERBIA......696
Matija Vojnović and Luka Lopičić

Chapter 58 SINGAPORE......706
Lim Mei and Lee Kee Yeng

Chapter 59 SLOVENIA......716
David Premelč, Bojan Šporar and Jakob Ivančič

Chapter 60 SOUTH AFRICA......727
Ezra Davids and Ashleigh Hale

Chapter 61 SPAIN......739
Christian Hoedl and Javier Ruiz-Cámara

Chapter 62 SWEDEN......755
Biörn Riese, Eva Hägg and Anna Brannemark

Chapter 63 SWITZERLAND......763
Lorenzo Olgiati, Martin Weber, Jean Jacques Ah Choon, Harun Can and David Mamane

Chapter 64 THAILAND......774
Troy Schooneman and Jeffrey Sok

Chapter 65 TURKEY......781
Tunç Lokmanhekim and Nazlı Nil Yukaruç

Chapter 66 UNITED ARAB EMIRATES......790
DK Singh and Stincy Mary Joseph

Chapter 67 UNITED KINGDOM......802
Mark Zerdin

Chapter 68 UNITED STATES......829
Richard Hall and Mark Greene

Chapter 69 VENEZUELA 869
Guillermo de la Rosa, Juan D Alfonzo, Nelson Borjas E, Pedro Durán A and Maritza Quintero M

Chapter 70 VIETNAM 882
Hikaru Oguchi, Taro Hirosawa, Ha Hoang Loc

Appendix 1 ABOUT THE AUTHORS 893

Appendix 2 CONTRIBUTING LAW FIRMS' CONTACT DETAILS 943

EDITOR'S PREFACE

There is cause for optimism and caution in light of the past year's events.

First, we can be tentatively optimistic about Europe. The possibility of a euro breakup appears to have faded, and European equities markets performed, on the whole, exceptionally well in 2013. Indeed, the euro/dollar basis swap has moved sufficiently to open up euro capital markets to borrowers wishing to swap proceeds to dollars; the World Bank sold its first euro benchmark bond for more than four years in November 2013, and non-European companies like Sinopec and Korea Natural Gas have issued large euro bonds in recent months. If the European economy continues to grow (and analysts are expecting growth to quicken), it is hoped that the prospect of crisis will continue to fade.

Second, though 2013 was a comparatively languid year for global M&A, the buoyancy of the credit and equity markets cannot be ignored. In terms of financing, the seeming willingness of banks to allow for looser borrower constraints, to underwrite jumbo facilities in small syndicates, and to offer flexible and fast bridge-financing for high-value acquisitions, presents a financing climate that should be particularly amenable to corporate M&A. It is also notable that continued political and economic instability did not impede the completion of some standout deals in 2013, including the *Glencore/ Xstrata* tie-up and Vodafone's disposal of its shareholding in Verizon Wireless. These deals show that market participants are able, for the right deal, to pull out all the stops. After a period of introspection and careful balance sheet management, corporates may be increasingly tempted to put cash to work through M&A.

There remains, however, cause for prudence. There is considerable uncertainty as to how markets will process the tapering of quantitative easing (QE) by the US Federal Reserve. The merest half-mention by Ben Bernanke, in May 2013, of a possible end to QE was enough to shake the markets, and to nearly double the 10-year US Treasury yield in a matter of months. Emerging markets are particularly sensitive to these shocks. The oncoming end of QE may already have been priced into the markets, but there is a possibility that its occurrence will cause further, severe market disruption. In addition, there are concerns around how the funding gap left by huge bank deleveraging will be

filled, and centrifugal pressures continue to trouble European legislators. Finally, there are broader concerns as to the depth of the global economic recovery as growth in the BRIC economies seems to slow. Optimism should, therefore, be tempered with caution.

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

Mark Zerdin
Slaughter and May
London
August 2014

Chapter 68

UNITED STATES

Richard Hall and Mark Greene[1]

I OVERVIEW OF M&A ACTIVITY

Global credit and equity markets soared in 2013, seeing their best year since 2007 and 2010, respectively, but mergers and acquisitions (M&A) activity did not follow suit.[2] Global M&A activity took a dismal turn in 2013, with overall value down 6 per cent from 2012 levels, making it the slowest annual period for worldwide M&A since the financial crisis.[3] In the United States (US), year over year loan volume was up 40 per cent and equity issuances from US issuers were up 13 per cent. However, despite high expectations grounded in a stabilising US economy and a seemingly healthy M&A pipeline, the flow of overall US M&A activity in 2013 was lukewarm at best, as lingering headwinds from 2012 and new challenges led to uncertainty that muted M&A activity.[4] The eurozone struggled to maintain momentum after arguably emerging from a recession. In the US, there was much handwringing over the debt ceiling crisis, the fourth quarter shutdown of the federal government and the announcement by the US Federal Reserve that it was the beginning of the end of its bond buy-back programme. In other parts of the world,

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 Jennifer Conway, Len Teti and Christine Varney and associates Stephanie Alexis, Athena Cheng, Caitlin Fitzpatrick, Margaret Segall D'Amico, Michelle Garrett, Edward McGehee and Erik Stegemiller.

2 Global Syndicated Loans Review, Full Year 2013, Managing Underwriters, Thomson Reuters (2014), http://online.thomsonone.com; Global Equity Capital Markets Review, Full Year 2013, Managing Underwriters, Thomson Reuters (2014), http://online.thomsonone.com.

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

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

unrest in Syria and Egypt and a changing of the guard in the People's Republic of China also contributed to uncertainty.

2013 US M&A activity by dollar volume increased by 4.4 per cent over 2012 levels, while 2013 deal count decreased 3.4 per cent over the comparable 2012 period.[5] Quarter to quarter, US M&A activity was a bit of a bumpy ride. The twelve months ended 31 December 2012 finished optimistically, but the first quarter of 2013 sharply pulled back from 2012's fourth quarter surge, resulting in total dollar volume of approximately $263.1 billion, down approximately 26.7 per cent from the previous quarter.[6] The decline levelled off in the second quarter with dollar volume decreasing 5.4 per cent from the first quarter.[7] Suddenly, in the third quarter, US M&A activity saw significant upward movement as compared to the previous quarter, with dollar volume increasing by 49.7 per cent due in no small part to the announcement of Verizon Communications Inc.'s now completed acquisition of the remaining 45 per cent stake in Verizon Wireless Inc. for approximately $130.0 billion (the Verizon Wireless transaction).[8] Without another Verizon Wireless transaction sized deal to swell volume, US M&A activity in the fourth quarter decreased 28.4 per cent as compared to the third quarter with dollar volume at approximately $315.6 billion.[9] US M&A activity rose in the first quarter of 2014, up 33.9 per cent as compared to the fourth quarter of 2013 for a total dollar volume of $419.0 billion, though deal count decreased by 15.6 per cent as compared to the fourth quarter of 2013.

Shifting focus to US targeted M&A, the market was more promising.[10] For the twelve-month period ended 31 December 2013, announced US targeted M&A was up 11.3 per cent by dollar volume year over year, with dollar volume of $1.04 trillion in 2013 as compared to $935.0 billion in 2012.[11] However, the double digit increase in dollar volume was accompanied by relatively flat levels in deal count (a decrease of

5 Mergers & Acquisitions Review, Full Year 2013, Financial Advisors, *supra* note 3.

6 Figures derived from Mergers & Acquisitions Review, First Quarter 2013, Financial Advisors, Thomson Reuters (2013), http://online.thomsonone.com; Mergers & Acquisitions Review, Full Year 2012, Financial Advisors, Thomson Reuters (2013), http://online.thomsonone.com; Mergers & Acquisitions Review, First Nine Months 2012, Financial Advisors, Thomson Reuters (2012), http://online.thomsonone.com.

7 Figures derived from Mergers & Acquisitions Review, First Half 2013, Financial Advisors, Thomson Reuters (2013), http://online.thomsonone.com; Mergers & Acquisitions Review, First Quarter 2013, *supra* note 6.

8 Mergers & Acquisitions Review, First Nine Months 2013, Financial Advisors, Thomson Reuters (2013), http://online.thomsonone.com; Press Release of Verizon Communications Inc., 'Verizon Completes Acquisition of Vodafone's 45 Percent Indirect Interest in Verizon Wireless', issued on 21 February 2014, http://newscenter.verizon.com/corporate/news-articles/2014/02-21-acquisition-of-vodafone-stake-in-vzw-complete.

9 Mergers & Acquisitions Review, Full Year 2013, Financial Advisors, *supra* note 3.

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

11 Mergers & Acquisitions Review, Full Year 2013, Financial Advisors, *supra* note 3; Mergers & Acquisitions Review, Full Year 2012, *supra* note 6.

0.5 per cent), and was primarily driven by several mega-deals.[12] Ten of the top fifteen largest transactions announced worldwide in 2013 involved US targets.[13] Topping the list was the then pending Verizon Wireless transaction and rounding out the bottom of the top fifteen was American Realty Capital Properties, Inc.'s now completed acquisition of Cole Real Estate Investments, Inc. for approximately $11.2 billion.[14] US targeted M&A continued to strengthen in the first quarter of 2014 rising 49 per cent by dollar volume as compared to the fourth quarter of 2013, reaching $367.0 billion (including competing bids for Time Warner Cable Inc. for $70.6 billion and $62.6 billion).[15]

US public company M&A continued on its steady decline with 2013 deal count at its lowest level since 2009 and debt financed M&A at its lowest level since 2010.[16] The split between strategic and financial acquirers continued to hover around 75 per cent to 25 per cent, respectively, with approximately 30 per cent of acquirers using their stock as all or a portion of consideration – a number that has stayed consistent on average since the second half of 2012.[17] This is in contrast to the less than 20 per cent of US public company M&A deals in which stock was used as all or a portion of consideration in the first half of 2012 and in 2011.[18]

Overall, in 2013 US companies refocused their acquisitive gaze inward. The value of domestic deals[19] increased 9.1 per cent over 2012 levels, making 2013 the most active year for domestic deals since 2007, while US outbound M&A was down 6 per cent from 2012 levels.[20]

Access to inexpensive capital was readily available in 2013 with appetite for leverage reminiscent of pre-crisis levels, however, much less of those funds went towards M&A activity than during the credit boom. US leveraged buyout (LBO) activity remained relatively quiet in 2013, seeing a decline in dollar volume and deal count as compared to 2012.[21]

12 Mergers & Acquisitions Review, Full Year 2013, Financial Advisors, *supra* note 3.

13 Id.

14 Id.; 'American Realty Capital Properties Completes Acquisition of Cole Real Estate Investments Creating Largest Net Lease REIT', *PR Newswire*, 7 February 2014, www.prnewswire.com/news-releases/american-realty-capital-properties-completes-acquisition-of-cole-real-estate-investments-creating-largest-net-lease-reit-244220231.html.

15 Mergers & Acquisitions Review, First Quarter 2014, Financial Advisors, Thomson Reuters (2014), http://online.thomsonone.com.

16 Practical Law Company, 'What's Market: 2013 Public M&A Wrap-up', 1 February 2014, http://us.practicallaw.com/9-554-9589?q=&qp=&qo=&qe=.

17 Id.

18 Id.

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

20 'Mergermarket M&A Trend Report: 2013', Mergermarket, January 2014, www.mergermarket.com/pdf/Mergermarket.2013.LegalAdvisorM&ATrendReport.pdf.

21 Cross-Market Commentary: The Value Of Announced LBOs in 2013 Dropped Compared With 2012 Levels', 2 January 2014, www.standardandpoors.com/products-services/articles/en/us/?articleType=HTML&assetID=1245362578768.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

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

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

Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the HSR Act), an acquirer is normally required to make a filing with US antitrust authorities prior to completing the acquisition. Generally, the HSR Act requires notification if the size of the transaction exceeds $75.9 million (adjusted annually for inflation); the requirement was increased from $70.9 million in 2013.[22]

There is no general statutory review process governing foreign investment in the United States. Under the Exon-Florio Amendment to the Defence Production Act of 1950 (Exon-Florio Amendment), however, the President, through the Committee on Foreign Investment in the US (CFIUS), has the power to review, investigate, prohibit or unwind transactions involving investments by non-US entities that threaten to impair national security.[23] The 1992 Byrd Amendment also requires CFIUS to conduct a full Exon-Florio investigation whenever CFIUS receives notice of a foreign government-led takeover of a US business that may affect national security.[24]

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, broadcast licences, electric and gas utilities.

22 'FTC Announces Revised Thresholds for Clayton Act Antitrust Reviews for 2014', Federal Trade Commission, www.ftc.gov/news-events/press-releases/2014/01/ftc-announces-revised-thresholds-clayton-act-antitrust-reviews.

23 50 U.S.C. app, Section 2170.

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

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Scrutiny under *Revlon*

The case of *Koehler v. Netspend Holdings Inc.* both emphasised the reasoned thoughtfulness that should exist behind a board of director's use of 'don't ask, don't waive' standstill provisions and underscored the Delaware Court of Chancery's reluctance to enjoin mergers in the face of a flawed sale process where no competing offer has been put forth, the available offer is at a substantial premium and the shareholders are in a position to vote on the merger.[25]

Once a board of directors decides to embark on a transaction that will result in a change of control of the company (i.e., a transaction where there will be a new controlling shareholder or in which at least 50 per cent of the consideration will be cash), the board's decisions will be subject to review under the *Revlon* standard.[26] *Revlon* is not independent from the directors' fiduciary duties of loyalty and care, but rather a restatement of those duties, requiring the directors to use reasonable efforts to secure the best value reasonably attainable for the company's shareholders.[27] *Revlon* duties heighten the level of scrutiny under which a change of control transaction will be reviewed, focusing on reasonableness rather than rationality, which would be the case for the business judgement rule which generally applies to ordinary business decisions.[28] Reasonableness requires that the board of directors be informed and that it construct a sales process to maximise value in light of that information.[29]

In *Netspend*, the plaintiff sought to preliminarily enjoin the acquisition of Netspend Holdings Inc. (Netspend) by Total System Services, Inc. (TSYS) pursuant to which each common shareholder would receive $16.00 per share.[30] Netspend did not conduct a pre-market check before entering into the agreement and plan of merger with TSYS and negotiated with TSYS exclusively throughout the sale process.[31] The transaction with TSYS included the following package of deal-protection measures: a no-shop covenant prohibiting Netspend from actively conducting a post-signing market check, a termination fee of 3.9 per cent (approximately $53.0 million) and matching rights.[32] TSYS had also entered into voting agreements under which approximately 40 per cent of Netspend's shares were committed to vote for the merger.[33] In addition, prior to engaging in discussions with TSYS, Netspend had agreed to help its largest shareholder sell its minority stake privately and in the process entered into confidentiality agreements

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25 *Koehler v. NetSpend Holdings Inc.*, Del. Ch., C.A. No. 8373, Glasscock, V.C. (21 May 2013) (Mem. Op.)

26 *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 242 (Del. 2009).

27 *Netspend*, C.A. No. 8373 at 31.

28 Id.

29 Id.

30 Id. at 26.

31 Id. at 14-26.

32 Id. at 27.

33 Id.

with two potential private equity buyers which contained standstill provisions that did not fall away upon Netspend's announcement of another transaction.[34] The merger agreement prevented the Netspend board of directors from waiving these provisions without the consent of TSYS.[35]

While the Court of Chancery did not find the use of a single-bidder process *per se* unreasonable, it noted that, in the context of such a process, when a board of directors decides to forego a pre-market check, that decision must inform the sale process moving forward, and its actions 'in toto must produce a process reasonably designed to maximise price'.[36] The Court of Chancery next focused on the fairness opinion received by the Netspend board of directors, addressing the weakness of certain valuations used within it (e.g., two of the valuations were based on Netspend's stock price which Netspend believed to be undervalued) and noting that the discounted cash-flow analysis indicated that the agreed price was inadequate.[37] While not questioning the board of director's reliance on the opinion, the Court of Chancery stated that the opinion could not substitute for a market check.[38] The Court of Chancery found that in light of these factors, the Netspend board of directors had to be 'particularly scrupulous' in creating a sale process that ensured it was fully informed so that it could determine whether maximum value had been realised.[39]

The Court of Chancery then reviewed the deal protection devices as a package, quickly dispensing with the idea that the voting agreements, termination fee and matching rights posed any credible threat to a superior offer and instead focusing on the no-shop and the 'don't ask, don't waive' standstill provisions. The Court of Chancery found that while agreeing to a no-shop was not *per se* unreasonable, the Netspend board of directors, particularly in light of the short period anticipated between signing and closing, failed to use it as an opportunity to determine whether maximum price had been achieved. In a footnote, the Court of Chancery distinguished *In re Plains Exploration & Production Company Stockholder Litigation* which had been decided earlier in the year, in which the board of directors also did not conduct a pre-market check, but the mild deal protections and a meaningful gap of five months between signing and closing served as an adequate alternative to a market check.[40] With respect to the 'don't ask, don't waive' provisions, the Court of Chancery found that the Netspend board of directors had not given any consideration as to whether the provisions should have remained in place and therefore 'blinded' itself to any potential offers from the private equity bidders.[41] As relics from a previous transaction, the Court of Chancery noted that once *Revlon* duties attached, the Netspend board of directors should have waived the provisions.

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34 Id. at 9-11.

35 Id. at 27.

36 Id. at 45.

37 Id.

38 Id. at 47.

39 Id. at 37.

40 Id. at 52.

41 Id. at 53.

In looking at the sale process in totality and focusing in particular on the Netspend board of directors' 'thoughtless' use of the 'don't ask don't waive' standstill provisions, the Court of Chancery found that the Netspend board of directors approved the $16.00 price without adequately informing itself of whether it was the highest consideration that could reasonably be obtained for Netspend shareholders.[42] Despite these findings, the Court of Chancery denied the request for a preliminary injunction, finding that although the Netspend board of directors would likely fail to meet their burden at trial of proving they had satisfied their *Revlon* duties, any injunction would unduly put at risk, potentially forever, the shareholders' opportunity to receive a premium for their shares and therefore the balance of equities weighed against enjoining the merger.[43]

Netspend made clear that while a board of directors can pursue a single bidder process without a pre-signing check, it must be 'particularly scrupulous' in its design of the rest of the sale process understanding that the single bidder process informs the rest of the analysis. *Netspend* also is an example of *Revlon* serving not as a separate set of affirmative duties, but rather as a form of enhanced scrutiny falling between deference to the board of directors under the business judgement rule and scepticism under the more exacting entire fairness test (applied in conflict of interest transactions).[44] When *Revlon* was initially handed down, it was thought that it imposed an affirmative duty on boards of directors to auction a company in the context of a sale.[45] Nearly three decades of caselaw later has clarified that this is not the case, and that while the end-goal is clear – obtaining the best value for a company's shareholders – the board of directors is 'generally free to select the path to value maximisation, so long as they choose a reasonable route to get there.'[46]

ii New standard of review for certain controlling shareholder transactions

In *In re MFW Shareholders Litigation* the Delaware Court of Chancery issued a seminal opinion establishing that the deferential business judgement rule is the appropriate standard of review in the case of a merger between a controlling shareholder and its subsidiary where from the outset the controlling shareholder agrees the transaction will be conditioned on the approval of both an independent and empowered (to negotiate and not simply evaluate) special committee that fulfils its duty of care and the uncoerced and informed vote of a majority of the minority of shareholders unaffiliated with the controlling shareholder.[47]

42 Id.

43 Id. at 67.

44 Id. at 32.

45 *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986); J. Travis Laster, 'Revlon Is a Standard of Review: Why It's True and What it Means', 19 Fordham J. Corp. & Fin. L. 5, 6 (2013).

46 *In re Dollar Thrifty Shareholder Litigation*, 14 A.4d 573, 595-596 (Del. Ch. 2010); Laster, *supra* note 45 at 20.

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

Prior to *In re MFW*, where a controlling shareholder stood on both sides of a transaction, the actions of the target's board of directors were reviewed under the exacting entire fairness standard as the transaction was necessarily a conflicted one. Under entire fairness, the Delaware courts evaluate the entirety of the transaction focusing on two interrelated prongs: whether a fair process was used and whether a fair price was paid.[48] The best defendants could hope for was shifting the burden to plaintiffs by conditioning the transaction on either a special committee of independent directors or the approval of the majority of the minority of shareholders unaffiliated with the controlling shareholder.[49] The Delaware courts had never had occasion to opine on the appropriate standard of review if both protections were in place.

In *In re MFW*, the defendants argued that the use of both protections created an arm's-length dynamic that called for review under the business judgement rule, under which a Delaware court will not second-guess a board of directors' decision if it can be attributed to any rational purpose.[50] The Court of Chancery largely agreed with this reasoning and noted that, because controlling shareholders did not receive 'extra legal credit' for putting in place both legal protections (i.e., burden shifting remained the best possible outcome), there had been no incentive for them to do so.[51] Acknowledging that its decision could be overturned by the legislature or the Delaware Supreme Court, the Court of Chancery, after reviewing the independence of the special committee and whether or not it had been sufficiently empowered and had fulfilled its duty of care, adopted the business judgement rule as the appropriate standard of review.[52]

In March 2014, the Delaware Supreme Court upheld the Court of Chancery's decision, but modified the Court of Chancery's duty of care test.[53] The Supreme Court held that in particular the duty of care has to be met with respect to negotiating price.[54] In a footnote, the Supreme Court noted various claims in the class complaint regarding price (e.g., the final merger price was $2.00 lower than the company's trading price two months earlier) that could have called into question the sufficiency of the special committee's negotiations, requiring discovery to determine whether the test had been satisfied.[55] The Supreme Court's discussion regarding whether the special committee adequately conducted negotiations, in effect, blurred the lines between application of the business judgement rule and entire fairness. The type of allegations that the Supreme Court pointed to are common in complaints regarding controlling shareholder transactions. The Supreme Court's focus on due care with respect to price could limit

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

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

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

51 Id. at 500-01.

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

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

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

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

the benefits of the standard as established by the Court of Chancery necessitating extensive discovery and leaving a target board of directors in the context of a takeover by controlling shareholder, unsure as to whether the business judgement rule will ever apply to its actions.

iii Facilitation of the two-step merger

In August of 2013, Section 251 of the DGCL was amended to eliminate the requirement for a shareholder vote in certain two-step mergers. The addition of Section 251(h) addressed what many viewed to be a gap in the statutory framework.

A two-step merger is a hybrid acquisition structure for a target company that combines a tender or exchange offer (offer) with a 'back-end' merger, in which shareholder approval is a *fait accompli*, or a short-form merger, in which shareholder approval is not required by law. This is in contrast to a one-step long-form merger in which the shareholders of the target company generally have a meaningful vote on the transaction. The advantage of the two-step merger, in particular where the consideration is cash and regulatory review is not required, is speed. An all-cash two-step merger can be accomplished in a matter of weeks whereas a one-step merger can take several months.

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

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

increasing the potential number of competitive bids. The deal community has openly accepted the amendment, with 28 of the 30 Delaware-governed two-step mergers entered into between 1 August 2013 and 7 April 2014 opting in to Section 251(h) and 13 of the 28 deals containing a financing component.[56]

Fiduciary duties, however, are not cast aside just because of the speed at which a Section 251(h) deal can get done. The commentary to Section 251(h) is clear that the amendment is not intended to change the fiduciary duties or the judicial standard of review that would otherwise apply in the absence of Section 251(h).[57] Unlike in a Section 253 short-form merger, the sole remedy is not appraisal rights.[58]

Amendments have already been proposed to Section 251(h) to clarify ambiguities and eliminate certain restrictions that minimised certain of its expected advantages. Notably, Section 251(h) is currently unavailable if any party to the merger agreement at the time the agreement receives board approval is an 'interested stockholder' as defined in Section 203 of the DGCL (generally a holder of 15 per cent more of the target company's outstanding shares). This limitation was largely viewed by the deal community as restricting acquirers from entering into tender and support agreements with shareholders or groups of shareholders that owned 15 per cent of the target company's stock, forcing the acquirer to choose between the advantages of Section 251(h) and the assurance of locking up a significant portion of a target company's shares.[59] Proposed amendments would lift this ban, perhaps opening the door for Section 251(h) to be used in the context of 'going private' transactions.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

i Acquisition Inversions

The phenomenon of US corporations reincorporating in low-tax jurisdictions, so-called 'inversions', is not new. US tax rates are some of the highest globally and US-based companies consistently look for ways to shield their international earnings from those rates. In the past, a company was able to simply reincorporate in a foreign jurisdiction

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56 Carl Sanchez, Elizabeth Razzano and Laura McGurty, 'Tender Offers: Past, Present and Future – the Evolution of Section 251(h)', Paul Hastings LLP, May 2014, www.paulhastings.com/docs/default-source/PDFs/stay-current-251h-tender-offers.pdf.

57 Webcast, 'Tender Offers Under the New Delaware Law', DealLawyers.com (comments of Mark Morton), 30 October 2013, available at www.deallawyers.com/member/Programs/Webcast/2013/10_30/transcript.htm.

58 'US M&A: Looking Back at 2013 and Forward to a Brighter 2014', Skadden, Arps, Slate, Meagher & Flom LLP, https://www.skadden.com/global-ma/us-ma-looking-back-2013-and-forward-brighter-2014 (last visited 6 June 2014).

59 Allison L. Land, Edward P. Welch and Christopher M. Divirgilio, 'Proposed Amendments to the Delaware General Corporation Law', Skadden, Arps, Slate, Meagher & Flom LLP, 17 April 2014, www.skadden.com/insights/proposed-amendments-delaware-general-corporation-law-1.

or move to a country in which it was already doing a substantial amount of business.[60] Not surprisingly, as the US government saw taxable revenue escaping its reach, it made the rules and regulations governing when a company can qualify for an inversion more stringent. The US government's attempt to stop the revenue leak after a wave of inversions in the 1990s and then again in the early 2000s was more akin to whack-a-mole than a real solution and as of late there has been a resurgence of inversions.[61] It is estimated that there have been 50 inversions overall in recent decades with approximately 20 of them occurring over the past two years.[62]

Generally, Internal Revenue Service rules permit a US company to reincorporate in a foreign jurisdiction if it conducts substantial business in the new jurisdiction. In general this means that approximately 25 per cent of the company's sales, assets and employees are domiciled in the new jurisdiction.[63] This is a difficult burden for most companies to meet and today, most inversions are achieved through multibillion-dollar cross-border M&A, 'acquisition inversions'.[64] Under the acquisition inversion rules, 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 greater than 20 per cent of the combined entity's stock is owned by the former shareholders of the target company.[65]

One such cross-border deal utilising an acquisition inversion structure is the pending merger of Applied Materials, Inc., a Delaware corporation (Applied), and Tokyo Electron Limited, a Japanese corporation (TEL), valued at approximately $7.0 billion and announced in late September of 2013.[66] The transaction would be the second biggest takeover by a US acquirer of a Japanese target, trailing Citigroup Inc.'s acquisition of Nikko Cordial Corporation.[67] The merger is structured as an all-stock transaction, with the combined entity having a market value of about $29.0 billion. The combined entity would be incorporated in the Netherlands and though the transaction has been touted as a merger of equals, Applied is effectively acquiring TEL. Former shareholders of Applied and TEL would own 68 per cent and 32 per cent of the combined entity respectively.[68]

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

61 David Brown, 'The U.S. Tax Code is Bananas', Third Way, 22 May 2014, http://perspectives.thirdway.org/?p=3660.

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

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

64 Id.

65 Daniel E. Wolf and Todd F. Maynes, 'Opportunities and Challenges of Inversion Deals', *Law360*, 30 April 2014, www.law360.com/articles/532958/opportunities-and-challenges-of-inversion-deals.

66 Mergers & Acquisitions Review, First Nine Months 2013, *supra* note 8.

67 Reiji Murai and Supantha Mukherjee, 'Applied Materials, Tokyo Electron Deal Would Create Titan', Reuters, 24 September 2013 (on file with author).

68 See Applied Materials, Inc., Current Report (Form 8-K) (24 September 2013).

However, the governance structure does provide for a single tier evenly split board with each of Applied and TEL having the right to designate five directors with the eleventh director to be mutually agreed.[69] Additionally, the combined entity would maintain dual headquarters in California and Tokyo.[70] As a result of the combination, Applied estimates that its average effective tax rate would drop to 17 per cent from 22 per cent.[71] Based on Applied's nearly $2 billion of revenues in 2011, that would be a savings of about $100 million a year.[72]

The current wave of inversions has not gone unnoticed. The US government is currently scrambling to find a solution to the revenue loss, which over time could amount to billions of dollars.

ii CFIUS Review

Ralls update

In September 2012, President Obama blocked the first merger on CFIUS-related national security grounds in 22 years. Such authority was given to the President under the Exon-Florio Amendment, which was enacted amid concerns over foreign acquisitions, particularly Japanese firms.[73] The transaction at issue was the acquisition by Ralls Corporation (Ralls), a Delaware company owned by executives of China's largest machinery manufacturer, of four wind farm projects near the Naval Weapons Systems Training Facility in Oregon. Ralls had not notified CFIUS prior to the consummation of the transaction. Challenging the President's order, Ralls filed suit claiming that the order, *inter alia*, was an unconstitutional deprivation of property without due process. Having previously dismissed Ralls' other claims, in October 2013, the US District Court for the District of Columbia dismissed Ralls' due process claim.[74] Part of the Court's analysis focused on the fact that Ralls elected to not notify CFIUS prior to the closing and therefore acquired the property subject to the known risk of the presidential veto. The *Ralls* case underscores the importance of obtaining CFIUS clearance prior to closing a transaction.

69 Id.

70 Id.

71 Michael J. de la Merced and Eric Pfanner, 'U.S. Manufacturer of Chip-Making Equipment Buys Japanese Rival', *New York Times*, 24 September 2013, http://dealbook.nytimes.com/2013/09/24/applied-materials-to-merge-with-tokyo-electron/?_php=true&_type=blogs&_r=0.

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

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

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

Smithfield Foods

In May of 2013 Smithfield Foods, Inc. (Smithfield) announced that it was being acquired by Shuanghui International Holdings Limited, the majority shareholder of China's largest publicly traded meat products company measured by market capitalisation. The acquisition, with a total value of nearly $7 billion, closed in September of 2013 as the largest acquisition by a Chinese company of a US target.[75]

Perhaps taking a cue from *Ralls*, the Smithfield merger agreement expressly provided that the transaction was conditioned on CFIUS clearance and the parties offered to mitigate any perceived national security risk. Typically, CFIUS review, which is generally initiated based on the filing of voluntary notices, has largely covered transactions in the manufacturing sector, which accounted for 41 per cent of transactions reviewed from 2008–2012 (with about half of those transactions in the computer and electronic products sector).[76] The wholesale, retail and transportation industries only accounted for 8 per cent of transactions from 2008–2012, with the general industry in which Smithfield operates accounting for a small slice of the 8 per cent. Despite not being the type of transaction typically reviewed by CFIUS, in July 2013, CFIUS notified the parties that it would be conducting a second-phase 45-day investigation of the proposed transaction. The CFIUS review process consists of an initial 30-day period during which CFIUS reviews the transaction to consider its effects on US national security. If CFIUS still has national security concerns after the initial period, a second 45-day investigation is launched. From 2010 to 2012, after a drastic decrease during the financial crisis, the number of transactions proceeding to the investigation stage has steadily increased to 39 per cent in 2012 up from 36 per cent in 2011.[77] CFIUS review of *Smithfield* may indicate that the panel is expanding its focus beyond industries traditionally associated with national security.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

The telecommunications sector led the US market for 2013, primarily due to the Verizon Wireless transaction, with deal volume totalling $179.7 billion for 17.3 per cent of market share.[78] Energy and power followed, with dollar volume of $143 billion for 13.8

75 Press release of Smithfield Foods, Inc., 'Shuanghui International and Smithfield Foods Agree to Strategic Combination, Creating a Leading Global Pork Enterprise, issued on 29 May 2013, http://investors.smithfieldfoods.com/releasedetail.cfm?ReleaseID=767743; Press release of Smithfield Foods, Inc., 'Shuanghui International and Smithfield Foods Complete Strategic Combination, Creating a Leading Global Pork Enterprise', issued on 26 September 2013, http://investors.smithfieldfoods.com/releasedetail.cfm?releaseid=793522.

76 James K. Jackson, 'The Committee on Foreign Investment in the United States (CFIUS)', *Congressional Research Service*, 6 March 2014, www.fas.org/sgp/crs/natsec/RL33388.pdf.

77 Id.

78 Mergers & Acquisitions Review, Full Year 2013, Legal Advisors, Thomson Reuters (2014), http://online.thomsonone.com.

per cent of market share.[79] In terms of deal count, the technology industry led the charge with 1,458 deals, outpacing the next most active sector, consumer products and services, by 484 deals.[80]

i Technology

2012 proved to be a lacklustre year for technology M&A and looking at 2013 totals would give the impression that 2013 was not any different – with deal count and dollar volume declining 18 per cent and 3 per cent respectively for closed transactions.[81] However, after quarterly technology dollar volume dropped below 2009 recession levels in the first half of 2012, tides turned in the second half with dollar volume doubling, including the closing of the Dell Inc. $19 billion management buyout, the sector's largest transaction since 2007.[82] Software represented over a third of the sector's deal count in 2013, a trend that is expected to continue in 2014 as growth in data analytics, cloud technology and mobility continues. The largest software transactions to close in 2013 included the $6.9 billion acquisition of BMC Software Inc. by an investor group that was the third largest private equity deal of 2013.[83] Structured as 'go-private' transactions, the Dell Inc. deal and the BMC Software Inc. deal allow the companies to more aggressively seek market gains out from under the scrutiny of the public eye.

US equity markets were much livelier, with the Dow Jones, NASDAQ and S&P 500 setting record highs in 2013, rising 26.5 per cent, 38.3 per cent and 29.6 per cent respectively, during the year.[84] The technology sector took advantage of the market, with IPOs at their highest since 2007 (51 in total, up from 39 in 2012) accounting for 16 per cent of dollar volume and 21 per cent of deal count, respectively.[85] Among 2013's notable transactions was the IPO of Twitter, Inc. (Twitter), valued at $14.2 billion.[86] After Facebook, Inc.'s disastrous IPO in 2012, the market was nervous ahead of Twitter's debut – trepidation which was unfounded as Twitter's share prices saw a gain of 73 per cent over the IPO price at the close of the first trading day.[87]

Looking forward to 2014, the top 25 technology companies have almost $350.0 billion in cash and securities on hand. The industry seems primed for a resurgence.

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79 Id.

80 Id.

81 Tom Erginsoy, 'US Technology Deal Insights', PricewaterhouseCoopers LLP, February 2014, www.pwc.com/en_US/us/transaction-services/publications/assets/pwc-us-technology-deal-insights-2013.pdf.

82 Id.

83 Aaron Ricadela and Sarah Frier, 'BMC Software's $6.9 Billion Buyout Reflects Cloud Shift', *Bloomberg*, 6 May 2013, www.bloomberg.com/news/2013-05-05/bmc-said-to-be-close-to-be-taken-private-by-bain-golden-gate.html.

84 Erginsoy, *supra* note 81.

85 Id.

86 Id.

87 Julianne Pepitone, '#WOW! Twitter Soars 73% in IPO', *CNN Money*, 7 November 2013, http://money.cnn.com/2013/11/07/technology/social/twitter-ipo-stock/.

2014 has already seen the announcement of a number of billion-dollar technology deals, including Facebook, Inc.'s proposed acquisition of WhatsApp Inc. valued at nearly $19.5 billion.[88]

ii Consumer products

Consumer products saw a bright year with total dollar volume for 2013 for announced transactions exceeding $100 billion for the first time since 2008.[89] The acquisition of H.J. Heinz Company by Berkshire Hathaway and an affiliate of 3G capital (Heinz LBO) was the standout transaction of year, with a total value of approximately $28.0 billion.[90] Sysco Corporation's pending acquisition of US Foods, Inc. was the largest corporate transaction of 2013, with a total value of approximately $8.2 billion.[91] Though sector deal count was down 2 per cent in 2013, average deal size increased 67 per cent from 2012 to $399.0 million.[92]

IPO volume and proceeds saw a satisfying increase from 2012. Proceeds reached $10.3 billion, a 20 per cent increase over 2012.[93] The years saw 29 IPOs compared to 22 in 2012, a nearly 32 per cent increase, reflecting the strength of the 2013 equity markets and investor appetite for low-volatility growth companies.[94]

Food and beverage transactions continued to primarily drive the sector, accounting for 24 per cent of sector deal count and 50 per cent of sector dollar volume in 2013, as compared to 24 per cent and 41 per cent in 2012, respectively.[95] Restaurant deal count declined for the third year accounting for approximately 2 per cent of the sector in 2013 – three deals in total as compared to 13 in 2011 and 10 in 2012.[96]

Core retail sales during the fourth quarter of 2013 saw a year over year increase of 4.2 per cent, setting a positive tone for 2014.[97] With last year's instability regarding monetary and fiscal policy subsiding and home value improving, consumers will likely remain cautiously optimistic as the year continues. Though dollar volume has decreased in the first quarter of 2014 as compared to first quarter of 2013 without a Heinz LBO

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88 David McLaughlin and Stephanie Bodoni, 'Facebook WhatsApp Bid Seen Avoiding U.S. Antitrust Case', *Bloomberg*, 20 February 2014, www.bloomberg.com/news/2014-02-20/facebook-s-whatsapp-deal-seen-avoiding-u-s-antitrust-challenge.html.

89 Leanne Sardiga, Todd Weissmueller and Krystin Weseman, 'US Retail and Consumer Deals Insights 2013 Year In Review and 2014 Outlook', February 2014, www.pwc.com/en_US/us/transaction-services/publications/assets/deal-insights-2013-review.pdf. Discussion in this subsection focuses on transactions with a dollar volume of $50 million or greater.

90 Id.

91 Id.

92 Id.

93 Id.

94 Id.

95 Id.

96 Id.

97 Id.

sized deal to boost numbers, deal count remains fairly consistent.[98] The 2014 pipeline remains healthy with the first quarter of 2013 seeing five deals with a dollar volume of over $1 billion as compared to six deals in the first quarter of 2013.[99]

iii Shareholder activism

In 2013 shareholder activism went mainstream. Like the corporate raiders of the past, activist investors have emerged as the new threat with even strong billion-dollar companies left exposed. In 2012, Oshkosh Corporation was the only billion-dollar company to have a contested board election.[100] Looking at proxy season 2013, in addition to the overall number of proxy contests rising (from 24 to 35 when looking at Russell 3000 companies), 40 per cent of companies targeted had a market capitalisation of over $1 billion (e.g., Microsoft Corporation and Air Products and Chemicals, Inc.).[101] Boards of directors for companies of all sizes must now actively prepare and be willing to engage with activists, though there is no one-size-fits-all approach to dealing with activists. The impending threat of activist activity has put boards of public companies on the offensive, sometimes spinning off divisions or instituting return of capital programs before dissension has begun.[102] Activist investors have been able to extend their reach due to the steady erosion of structural defences. Through the third quarter of 2013, looking at the S&P 500, only 7 per cent of companies have poison pills in place, 15 per cent had staggered boards and 8 per cent failed to adopt a majority plus or plurality-plus voting standard in the election of directors.[103] The nature of activism has also seen a shift with 2013 seeing movement away from corporate governance initiatives to value-based activism, whether it is short-term strategies such as buybacks or sales or long-term strategies such as board structure and membership).[104] Some worry the constant scrutiny may be distracting and cause boards of directors to lose sight of the big picture as they respond to immediate pressures.

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98 Rob Shelton and Josh Smigel, 'US Retail and Consumer Deals Insights 2013 Year In Review and 2014 Outlook', May 2014, www.pwc.com/en_US/us/transaction-services/publications/assets/deals-insights-q1-2014.pdf.

99 Id.

100 Steven M. Davidoff, 'As Shareholder Fights Heat Up, Activists Aim at Bigger Targets', *New York Times*, 16 April 2013 http://dealbook.nytimes.com/2013/04/16/as-shareholder-fights-heat-up-activists-aim-at-bigger-targets/?_php=true&_type=blogs&_r=0.

101 David A. Katz and Laura A. McIntosh, 'The Mainstreaming of Shareholder Activism in 2013', New York Law Journal, 26 September 2013, www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.22861.13.pdf.

102 David Gelles, 'Boardrooms Rethink Tactics to Defang Activist Investors', *New York Times*, 11 November 2013, http://dealbook.nytimes.com/2013/11/11/boardrooms-rethink-tactics-to-defang-activist-investors/.

103 Katz and McIntosh, *supra* note 101.

104 William Mills, 'How 2013 Shareholder Activism Will Influence Future M&A', *Law360*, 29 January 2014, www.law360.com/articles/503167/how-2013-shareholder-activism-will-influence-future-m-a.

In the wake of the Dole Food Company, Inc. (Dole), management buyout, which closed in the fourth quarter of 2013, it appears hedge funds may be adding the battle for appraisal rights to their activist repertoires.[105] 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.[106] 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.[107] While appraisal rights are generally not a lucrative pursuit for the average shareholder, activist funds have the resources to make it worth their while. New hedge funds, like Merion Capital LP, are even specialising in appraisal rights and Merion Capital LP has averaged an 18.5 per cent annualised return across five completed appraisals, four of which settled.[108] Appraisal claims were brought on 17 per cent of takeovers of Delaware companies in 2013, the most since 2004, if not earlier. Based on deal prices, those claims were valued at $1.5 billion, an eightfold increase from 2012.[109] So far this year, at least 20 appraisal claims have been filed in Delaware courts, compared with 28 in all of 2013.[110]

In the case of the Dole management buyout, Dole is now left with a potential liability that starts at $190 million.[111] Activist participation in the appraisal rights arena could have a real impact on deal pricing as acquirers may not want to run the risk down the road of incurring a large unexpected liability. Whether the battle for additional value through appraisal rights will make acquirers more gun shy or generous remains to be seen.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Credit markets continued to strengthen over 2013. US debt capital markets set another annual record for high yield debt issuances with 2013 proceeds up 2.8 per cent as

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

106 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.

107 Id.

108 Steven M. Davidoff, 'A New Form of Shareholder Activism Gains Momentum', *New York Times*, 4 March 2014 http://dealbook.nytimes.com/2014/03/04/a-new-form-of-shareholder-activism-gains-momentum/?_php=true&_type=blogs&_r=0; Liz Hoffman, 'Hedge Funds Wield Risky Legal Ploy to Milk Buyouts,' *Wall Street Journal*, 13 April 2014, http://online.wsj.com/news/articles/SB10001424052702303887804579500013770163966.

109 Hoffman, *supra* note 108.

110 Id.

111 Davidoff, 'A New Form of Shareholder Activism Gains Momentum', *supra* note 108.

compared to 2012, reaching a total of $335.2 billion.[112] 2013 dollar volume of US investment grade debt issuances inched past 2012's all-time high, exceeding the $1 trillion mark for the second year in a row.[113] Overall syndicated lending was up 40.2 per cent over 2012 levels, with total dollar volume of $2.26 trillion.[114] US leveraged lending saw its best year since the credit boom, surpassing 2006 and 2007 (the peak boom years) with US leveraged loan volume reaching $1.22 trillion, up 61 per cent over full year 2012.[115] The year's generous extension of credit was bolstered by the Verizon Wireless transaction, with an initial portion of the financing in the form of a $61 billion bridge loan which was then reduced by a $49 billion bond issuance, the largest bridge loan and bond issuance on record for a corporate issuer.[116] The bond issuance in connection with the Verizon Wireless transaction rocketed past the previous record held by Apple Inc. of $17 billion set earlier in the year.[117]

However, in the world of syndicated lending the brakes appear to have been applied at the start of 2014, with first quarter overall US syndicating lending and US leveraged loan values and deal count generally down as compared to fourth and first quarters of 2013.[118] Debt capital markets saw a surge in investment grade debt, up 12.2 per cent compared to the first quarter of 2013, resulting in the second largest quarterly volume on record.[119]

Despite credit boom like leveraged loan volume, proceeds largely did not find their way into the M&A markets and instead were primarily used for refinancing existing debt, recapitalisation transactions such as dividend recapitalisations and other general corporate purposes. For example, nearly half of US leveraged loan volume was used for refinancing in 2013.[120] In addition, dividend recapitalisations remained a sweet spot with $69.9 billion throughout the year, exceeding 2012 levels which had already surpassed

112 Debt Capital Markets Review, Full Year 2013, Managing Underwriters, Thomson Reuters (2013), http://online.thomsonone.com.

113 Id.

114 Global Syndicated Loans Review, Full Year 2013, *supra* note 2.

115 Id.

116 'Verizon Prices Record-Breaking $49 billion bond deal', *CNBC*, 11 September 2013, www.cnbc.com/id/101008670; Press Release of Verizon Communications Inc., 'Verizon Reaches Agreement to Acquire Vodafone's 45 Percent Interest in Verizon Wireless for $130 Billion', issued on 2 September 2013, www.verizon.com/investor/news_verizon_reached_agreement_to_acquire_vodafones_45_percent_interest_in_verizon_wireless_for_130_billi.htm.

117 Charles Mead and Sarika Gangar, 'Apple Raises $17 Billion in Record Corporate Bond Sale', *Bloomberg*, 30 April 2013, www.bloomberg.com/news/2013-04-30/apple-plans-six-part-bond-sale-in-first-offering-since-1996-1-.html.

118 'Mergers & Acquisitions Review, First Quarter 2014, Financial Advisors', *supra* note 15.

119 Global Debt Capital Markets, First Quarter 2014, Managing Underwriters, Thomson Reuters (2014), http://online.thomsonone.com.

120 'Credit Markets Quarterly, 4th Quarter 2013', KPMG Corporate Finance LLC, (2013), www.kpminstitutes.com/advisory-institute/insights/2014/pdf/credit-markets-quarterly-update-2013-q4.pdf.

dividend recapitalisation levels during the credit boom and post-credit crunch years.[121] In 2012 anxiousness regarding the pending 'fiscal cliff' and handwringing over future tax rates contributed to the high volume of dividend recapitalisations. In 2013 the continued prevalence of dividend recapitalisations reflected access to funds at desirable rates.

As in 2012, the increased presence of institutional investors in the form of collateralised loan obligations funds (CLOs) and low interest rates contributed to high levels of liquidity flooding the market and an ever-more friendly borrower environment. CLO issuances totalled $81.3 billion in 2013, a 50 per cent increase from 2012.[122] The 2013 average yield on investment grade bonds stood at 3.49 per cent, just 0.9 basis points over 2012's record low average rate and below the average 4.3 per cent rate paid by the US government on 10-year bonds since 1992.[123] High-yield bonds started the year with average yields of 6.1 per cent and ended with average yields of 7.42 per cent, below the 10 year average rate of 9.1 per cent,[124] resulting in year-end returns nearly matching average-yield, an infrequent occurrence in the high-yield bond market.[125]

Borrowers capitalised on the shifting investor base and the desire for returns, with the issuance of covenant-lite loans (i.e., loans with no or only incurrence-based financial tests as opposed to maintenance financial tests) surpassing 2012 levels by leaps and bounds with dollar volume of $258 billion, a 197 per cent increase from 2012.[126] Second lien loans (i.e., priority of the lenders' liens in the collateral is lower than senior lenders' priority) also had a strong year, with issuances reaching $28.9 billion in 2013, a 63 per cent increase over 2012 and almost reaching 2007's record level.[127] With lender protections eroding, other additional borrower-friendly terms found their way to the market such as the expiration of call protections (i.e., lenders do not have to achieve a minimal level of profitability before the borrower can 'call' the loan), which has helped fuel refinancing, and pre-capitalisation provisions (i.e., permit the sale or change of control of the borrower to a permitted acquirer without causing an event of default).

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121 Id.

122 Practical Law Company, 'What's Market: 2013 Year-end Trends in Large Cap and Middle Market Loan Terms', 24 January 2014, http://us.practicallaw.com/1-554-9588?q=plc+what's+market+2013.

123 Global Debt Capital Markets, First Quarter 2014, *supra* note 119; Practical Law Company, 'What's Market: 2013 Year-end Trends in Large Cap and Middle Market Loan Terms', *supra*, footnote 122; Matt Wirz, 'Corporate Bonds Face Headwinds after a Heady 2012', *Wall Street Journal*, 1 January 2013, http://online.wsj.com/article/SB10001424127887324407504578185413635115082.html.

124 Id.

125 Michael Aneiro, '2013 Bond Scorecard: Junk Bonds Win with 7.42% Return', *Barron's*, 2 January 2014, http://blogs.barrons.com/incomeinvesting/2014/01/02/2013-bond-scorecard-junk-bonds-win-with-7-42-return/.

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

127 Id.

Despite the robust leveraged loan market, with private equity sponsors obtaining a record setting $530.0 billion of leveraged loans in 2013, with the $13.8 billion commitment backing the Dell LBO and the $13.1 billion commitment backing the Heinz LBO being the largest of such financings for the year, LBO activity in 2013 decreased as compared to 2012 levels.[128] Though the US was the most LBO active region in 2013, LBOs accounted for less than half of leveraged loan M&A activity (which represented 32 per cent of leveraged loan use of proceeds) in sharp contrast to 2007 levels where LBO activity accounted for over half of a much bigger piece of pie (2007 leveraged loan M&A activity represented 62 per cent of leveraged loan use).[129] Tolerance for leverage increased with the percentage of new LBOs with leverage ratios above six times at 27 per cent, the highest since 2007, when levels had been at 52 per cent.[130] However, US regulators are making their stance on excessive borrowing clear, with guidelines published in March 2013 (and letters sent directly to big banks in the summer of 2013) placing pressure on banks to hold the line on total leverage ratios of six times.[131] Applying these guidelines to the credit boom would have placed nearly 57 per cent (by dollar volume) of deals with loans of $1 billion or greater on the regulatory watch list.[132] 2013 LBO activity faced other headwinds, with stock prices and corporate profit margins at record highs, inflating purchase prices. Average premiums paid for US targets stood at 20 per cent in 2013, down from 33 per cent in 2012 and a record low average.[133] With regulators largely focused on new loans and turning their noses down at dividend recapitalisations, banks may feel overly constrained, forcing private equity sponsors to turn to debt capital markets or increase the equity they are willing to put on the line for a deal – an expensive proposition. Conditions do not appear ideal for an LBO surge in 2014, but with estimates of record levels of dry powder ($207 billion in North American-focused buyout funds),[134] and approximately 65 per cent of issuers

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128 Eric M. Rosof, Josh Feltman and Gregory E. Pessin, 'Wachtell Lipton on Acquisition Financing: the Year Behind and the Year Ahead', Colum. L. Blue Sky Blog, 18 February 2014, http://clsbluesky.law.columbia.edu/2014/02/18/wachtell-lipton-on-acquisition-financing-the-year-behind-and-the-year-ahead/; Global Syndicated Loans Review, Full Year 2013, *supra* note 2.

129 'Credit Markets Quarterly, 4th Quarter 2013', *supra* note 126.

130 Gillian Tan, 'Banks Sit out Riskier Deals', *Wall Street Journal*, 21 January 2014, http://online.wsj.com/news/articles/SB10001424052702304302704579334820201530010.

131 Id.

132 Steve Miller, 'Facing Regulators, LBO Woes, 2014 Leveraged Loan Issuers Have Tough Act to Follow', *Forbes*, 8 January 2014, www.forbes.com/sites/spleverage/2014/01/08/facing-regulators-lbo-woes-2014-leveraged-loan-issuers-have-tough-act-to-follow/.

133 Steve Miller, 'Facing Regulators, LBO Woes, 2014 Leveraged Loan Issuers Have Tough Act to Follow', *Forbes*, 8 January 2014, www.forbes.com/sites/spleverage/2014/01/08/facing-regulators-lbo-woes-2014-leveraged-loan-issuers-have-tough-act-to-follow/; David Weidner, 'Is the Market about to Get an M&A Boost', *MarketWatch*, 14 January 2014, www.marketwatch.com/story/is-the-market-about-to-get-an-ma-boost-2014-01-14.

134 'US M&A: Looking Back at 2013 and Forward to a Brighter 2014', *supra* note 58.

having already refinanced, repriced or recapped loans,[135] the question remains of how liquidity will be put to use.

VII EMPLOYMENT LAW

As a result of recent regulatory changes in the US, including the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in 2010 and the SEC regulations implementing that legislation, many of which are still forthcoming, shareholders of publicly traded companies in the US have been granted increased disclosure, and a louder voice, regarding the material components of such companies' executive pay practices (including an advisory vote known as a say-on-pay or SOP vote). SOP votes on executive compensation provide a platform from which shareholders may voice their opinions about executive pay practices employed by the company. Over the past four proxy seasons in which the SOP regulations have been in effect, certain patterns and practices have emerged as new standards, although the long-term effects of the regulatory changes remain unclear.

i Say-on-pay votes and compensation adjustments

Although SOP votes are non-binding, companies have generally demonstrated concern for the outcome as the influence of proxy advisory firms such as Institutional Shareholder Services (ISS) and Glass, Lewis & Co on such votes continues to grow. During 2011, 38 Russell 3000 companies received 'failed' SOP votes (defined as receiving 50 per cent or fewer votes in support, excluding abstentions), and during both 2012 and 2013, 58 Russell 3000 companies received failed SOP votes, many after a proxy adviser had recommended a 'no' vote.[136] As of mid-May 2014, eight Russell 3000 companies had failed SOP votes, compared to six Russell 3000 companies that had failed SOP votes as of mid-May 2013, and 11 per cent of companies received 'no' recommendations from ISS, as of mid-May 2014, compared to 12 per cent as of the end of May 2013.[137] Notably, as of mid-May 2014, only four Russell 3000 companies have failed SOP votes in more than one of the four proxy seasons in which the SOP regulations have been in effect, and, on average, Russell 3000 companies that have failed a SOP vote in a given year have

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135 Steve Miller, 'Facing Regulators, LBO Woes, 2014 Leveraged Loan Issuers Have Tough Act to Follow', Forbes, 8 January 2014, www.forbes.com/sites/spleverage/2014/01/08/facing-regulators-lbo-woes-2014-leveraged-loan-issuers-have-tough-act-to-follow/.

136 Frederic W Cook & Co, Inc, Executive Compensation 2012 Year in Review and Implications for 2013 and Beyond, 1 April 2013, at 1, www.fwcook.com/alert_letters/04-01-13_Executive_Compensation_2012_Year_in_Review_and_Implications_for_2013_and_Beyond.pdf, Semler Brossy, 2014 Say on Pay Results, 7 May 2014, at 7, www.semlerbrossy.com/wp-content/uploads/2014/05/SBCG-2014-Say-on-Pay-Report-2014-05-07.pdf. As of mid-May 2014, shareholder support for SOP proposals was 24 per cent lower at companies that received a 'no' recommendation from ISS.

137 Semler Brossy, 2014 Say on Pay Results, 7 May 2014, at 6, www.semlerbrossy.com/wp-content/uploads/2014/05/SBCG-2014-Say-on-Pay-Report-2014-05-07.pdf.

seen a 39 per cent increase in shareholder support for the SOP proposal the following year.[138] The small number of companies that have failed a SOP vote in multiple proxy seasons, and the significant increase in shareholder support for a SOP proposal in the year following a failed SOP vote, demonstrates that companies approach a failed SOP vote seriously and, in most instances, make substantive changes to their pay practices in response to investor concerns voiced through such failed vote.

Data suggest that companies with high CEO pay or low stock price performance, in each case, relative to their peer companies, are consistently the ones most at risk of a failed SOP vote.[139] Companies were increasingly focused on addressing this concern prior to the 2013 and 2014 proxy seasons, and a survey following the 2012 proxy season found that companies overwhelmingly expressed an intent to strengthen the link between pay and performance, as well as conduct a pay-for-performance analysis.[140] Indeed, many companies have altered their pay practices, at least with respect to their CEOs, presumably as a reaction to a real or perceived sense of low shareholder support for the existing programme, and there has been a noticeable shift, particularly among the largest companies, toward incentive-based pay, with more than 75 per cent of aggregate CEO compensation at companies in the S&P 1500 comprised of equity and performance-based short-term incentives.[141]

The SOP regulations have similar application to M&A transactions. Regulations grant to shareholders an advisory vote (a say on golden parachute or 'SOGP' vote) approving the amounts to be paid to executives upon a change in control (triggered by most types of M&A transactions). Certain change in control benefits which, historically, have been relatively common in connection with such transactions (e.g., 'single-trigger' acceleration of equity-based awards and gross-ups for the golden parachute excise tax pursuant to Section 280G of the US Internal Revenue Code, which applies to certain transaction-related payments above a threshold) have been singled out by proxy advisory firms and have drawn the particular ire of shareholders.[142] ISS's published policy guidance clearly states that it will render a negative SOP vote recommendation or a 'withhold' vote recommendation for the election of directors when a 280G gross-up is included in a new

138 Id. at 3-4.

139 Towers Watson, Presentation, Executive Compensation in the 2012 Proxy Season, 5 April 2012, at 4, www.towerswatson.com/assets/events/Towers-Watson-Exec-Compensation-in-the-2012-Proxy-Season-Presentation-April2012.pdf.

140 Towers Watson, Despite Strong Say-on-Pay Shareholder Support, Many U.S. Companies Continue to Sharpen Their Focus on Pay for Performance, Towers Watson Survey Finds, 8 November 2012, www.towerswatson.com/en/Press/2012/11/despite-say-on-pay-shareholder-support-many-US-companies-sharpen-focus-on-pay-for-performance.

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

142 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.

change-in-control agreement, even if no M&A transaction is imminent at the time such agreement is signed. [143] In addition, more recently ISS has indicated that it will consider legacy excise-tax gross-up and single-trigger acceleration provisions in determining its recommendation on SOGP proposals.[144] Of the 141 SOGP votes in 2013, 86 per cent passed, an increase from 82 per cent in 2012, although ISS recommended against 28 per cent of SOGP proposals, a sizeable increase from 20 per cent in 2012. Interestingly, while overall average support for the underlying merger transactions since the SOGP regulations became effective in 2011 was 99 per cent, the average support for SOGP proposals was approximately 88 per cent.[145]

ii Shareholder litigation

Through litigation, emboldened shareholders are applying increased formal pressure on companies to change their executive pay and disclosure practices. Following the adoption of the SOP regulations, the first wave of shareholder litigation focused on SOP votes that achieved less than 70 per cent support,[146] and recent shareholder litigation has additionally challenged director compensation, although not subject to a shareholder vote, specifically alleging insufficient equity plan limits on awards to directors.[147] The 2012 proxy season also saw the rise of a new form of shareholder litigation, with plaintiff firms launching investigations and at times initiating class action lawsuits immediately after the filing of a company's proxy statement, seeking to enjoin the shareholder meeting and the accompanying SOP vote and, in some instances, the binding vote to adopt or amend equity compensation plans or to increase the number of authorised shares under such plans. Such suits are similar to those seen in connection with an announced M&A transaction, seeking to enjoin a shareholder meeting to vote on the transaction. Suits in state courts allege that the directors breached their fiduciary duties by seeking

143 ISS 2014 U.S. Compensation Policy FAQ, Q&A 57, www.issgovernance.com/file/2014_Policies/ISSUSCompensationFAQs03282014.pdf. In the 2013 proxy season, only two companies (Hewlett-Packard Company and Kaman Corporation) had negative SOP vote recommendations from ISS reversed, and, in the case of Kaman Corporation, such reversal followed the company's decision to remove a 280G gross-up from an executive's recently renewed change in control agreement.

144 ISS 2014 U.S. Compensation Policy FAQ, Q&A 73 www.issgovernance.com/file/2014_Policies/ISSUSCompensationFAQs03282014.pdf.

145 Vipal Monga, 'Approval on Golden Parachutes Rose in 2013', *Wall Street Journal*, 30 December 2013.

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

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

shareholder approval on the basis of misleading and materially deficient proxy disclosure to shareholders.

Thus far, the courts have generally dismissed such cases, and, as of March 2014, no court has enjoined a vote on a company's SOP proposal, and only two of these shareholder suits have resulted in an injunction against votes on an equity plan proposal. In granting such injunctions, the courts found that each of the following omissions was material:

a projections that served as the basis for the board's decision to seek approval for the issuance of additional shares pursuant to an equity compensation plan;

b a summary of the analyses considered by the board in deciding to request shareholder approval; and

c an indication that an equity plan amendment is necessary to regain compliance with listing rules.[148]

In each of the two cases in which an injunction was granted, the shareholder vote only took place following the filing of supplemental proxy disclosures. Settlements were reached in a number of such suits as well, generally involving agreements to file supplemental proxy disclosures and to pay plaintiffs' attorneys' fees.[149] Despite the number of such cases in which companies refused to settle or meritless claims were dismissed, these claims continued to surface in 2013.[150] It remains unclear how courts will handle these challenges if they continue to persist in the coming years.

iii Looking ahead

Although predictions are always hazardous, the movements of the last few years point to areas that are almost certain to see interesting developments in the near future as a result of the changes described above. The most significant shift may emerge in the increasing engagement of companies with shareholders, as companies are expected to seek shareholder feedback on compensation programme design with greater frequency

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148 See *Knee v. Brocade Comm. Systems*, Case No. 1-12-CV-220249, Order (Cal. Sup. Ct. Santa Clara, filed 10 Apr. 2012) and *St. Louis Police Retirement System v. Severson*, Case No. 12-cv-5086 (N.D. Cal., filed 3 October 2012).

149 As these settlements are often confidential, the amount generally paid in attorneys' fees is difficult to determine. In *Knee v. Brocade Comm. Systems*, the stipulation of settlement provided for payment of fees and expenses up to $625,000, and in *Fisk v. H&R Block, Inc.*, the settlement provided for payment of attorneys' fees up to $225,000. See *Knee v. Brocade Comm. Systems*, Case No. 1-12-CV-220249, Stipulation of Settlement (Cal. Sup. Ct. Santa Clara) and *Fisk v. H&R Block, Inc.*, Case No. 1216-CV20418, Notice of Pendency of Class Action, Proposed Settlement of Class Action, Settlement Hearing and Right to Appear (Mo. Cir. Jackson County).

150 In one such case, a California court entered judgment in favour of the company following a non-jury trial, noting that proxy disclosure is not insufficient solely because of its failure to include certain information that may be considered 'helpful.' *Mancuso v. The Clorox Co.*, No. RG12-651653 (Cal. Sup. Ct. Alameda Cnty, 23 September 2013).

and focus on addressing the disparity between investor and management perceptions with respect to executive compensation.[151] Shareholders are also likely to continue exploring other avenues for influencing the pay practices of unresponsive companies. Thus far, director re-election has not been significantly affected by failed SOP votes, although, in at least one case, a company that received 80 per cent opposition to its SOP vote also saw two directors receive only 26 and 27 per cent support, respectively, for re-election – the lowest support of any S&P 500 company director in the preceding five years – and it is possible that shareholders will increasingly express frustration over compensation practices by voting against re-election of directors, particularly those involved in compensation decisions.[152] The practices identified as most troublesome by ISS and other proxy advisory firms likely will continue to disappear given the influence of proxy advisory firms on the outcome of SOP and SOGP votes, and compensation, even with respect to perquisites and other fringe benefits, is expected to continue to shift away from cash to equity and performance-based awards. It is unclear what the effect of the migration to equity and performance-based pay, coupled with the elimination of single-trigger vesting and increased shareholder engagement, will have on future M&A transactions.

VIII TAX LAW

During the past year, the public debate about reform of the US Tax Code has raged on. In particular, corporate tax reform has taken centre stage in recent months, as lawmakers have reacted to the continuing trend of corporate 'inversions'. These tax-advantaged transactions have prompted the Obama administration and some members of Congress to propose changes that would significantly curtail their benefits. The IRS also acted when, in April 2014, it issued a notice targeting certain types of transactions designed to avoid the shareholder-level tax that normally applies to inversions.

Aside from inversions, the IRS also issued proposed regulations under Section 381 of the US Tax Code, which addresses the transfer of tax attributes following certain corporate transactions. The proposed regulations would prevent certain acquirers from electing which entities succeed to a target corporation's tax attributes.

The common theme in all of these developments is the government's attempt to tighten rules that taxpayers have exploited to produce results that conflict with the government's idea of sound tax policy.

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

152 See Russell Gold and Daniel Gilbert, 'Chesapeake Directors Rejected by Shareholders', *Wall Street Journal*, 9 June 2012, http://online.wsj.com/article/SB10001424052702303753904577454132886187926.html.

i Inversions

Background

Before explaining how inversions work, it is perhaps best to explain the reason why companies find inversions attractive from a tax perspective. Under US tax law, US corporations are taxed on their worldwide taxable income. Where US corporations earn income through foreign subsidiaries, however, the income is generally not taxed in the United States until the foreign subsidiaries repatriate the income as a dividend or a loan. In addition, but perhaps even more importantly, US financial accounting rules permit US corporations to defer accruing tax expense for the income earned by their foreign subsidiaries if auditors conclude that the income is 'permanently reinvested' outside of the United States.

The predictable consequence of these tax and accounting rules is that many US corporations hold substantial amounts of cash in their foreign subsidiaries, and they cannot access that cash without triggering both a substantial cash tax liability and a large GAAP tax expense on their income statements. That is why foreign cash is frequently referred to as 'trapped cash.'

In contrast, foreign parent corporations are able to create a structure in which they hold US subsidiaries and non-US subsidiaries in separate ownership 'chains.' The US subsidiaries will be taxed in the United States on their worldwide income, but they generally will avoid owning any of the group's non-US subsidiaries. Instead, the group's non-US subsidiaries will be owned outside the US chain, and therefore those subsidiaries' earnings will never be subject to US tax.

A US corporation can begin to replicate this result by 'inverting' – that is, by becoming a subsidiary of a foreign corporation. After the inversion, the foreign corporation would seek to grow a non-US business as a separate ownership chain that does not include any US corporations. It might also cause the US chain to transfer foreign assets to the foreign chain, which would use those assets to grow the non-US business. Such a transfer would almost certainly result in some US tax cost, but the benefits of enabling future appreciation in the foreign assets to accrue outside of US taxing jurisdiction might well dwarf the upfront cost. Indeed, the non-US assets that could be moved outside of the US chain would thereafter produce earnings that would never be subject to US tax because the earnings would never have to flow through the US chain. And while the earnings themselves would often be taxed in non-US jurisdictions, the applicable tax rate would almost always be less than the current US corporate rate of 35 per cent. Moreover, the US chain could 'strip' US earnings by taking on debt, which would produce interest deductions that could lower the aggregate US taxable income even further.

The Current Landscape under Section 7874

There was a time when inverting was relatively easy. Indeed, before Congress amended the US Tax Code ten years ago, a US corporation could invert simply by forming a foreign corporate subsidiary and then merging with a merger subsidiary of that foreign corporation. In the merger, shareholders of the US corporation would exchange their shares for 100 per cent of the shares of the foreign corporation; following the transaction, the former shareholders of the US corporation would own 100 per cent of the shares of the foreign corporation, which would own 100 per cent of the shares of the US

corporation. The transaction was taxable at the shareholder level, even though the shareholders received no cash, but the structure itself was sound in that the US tax laws respected the new foreign parent as a foreign corporation. In fact, the structure worked even in the case where the foreign corporation was organised in a low-tax jurisdiction (e.g., Bermuda or Ireland) in which it did not have any substantial business activities.

Such an inversion is impossible now. In 2004, the United States enacted Section 7874 of its Tax Code, which provides that a US corporation cannot invert into a jurisdiction in which the inverted enterprise will have no substantial business activities, unless the historic shareholders of the US corporation own less than 80 per cent of the parent foreign corporation after the inversion. In other words, the US corporation seeking to invert to a jurisdiction in which it will have no substantial business activities must find a suitable partner for an M&A transaction, and that partner (or its shareholders) must be big enough such that its shareholders would receive more than 20 per cent of the resulting foreign corporation's stock in the transaction. This 80 per cent/20 per cent test is critical; if it is not met, the foreign corporation will be treated as a US corporation for US tax purposes, which, of course, defeats the whole purpose of inverting in the first place.

Section 7874 contains other inversion hurdles, too. If shareholders of the US corporation own at least 60 per cent but less than 80 per cent of the foreign corporation, the foreign corporation will not be treated as a US corporation, but the cost of moving assets out from under the inverted US company will be higher than before Section 7874's enactment. This is because Section 7874 prevents the inverted US company from using certain of its tax attributes (e.g., net operating losses) to shield taxable gain triggered by such transfers that occur in the 10 years after an inversion. In addition, whenever Section 7874 applies to an inversion, a 15 per cent excise tax applies to equity-based compensation held by top management of the US corporation.

Moreover, under rules that predate Section 7874, in any inversion in which the shareholders of the US corporation own more than 50 per cent of the foreign corporation, the transaction will result in the recognition of gain (but not loss) for the shareholders of the US company, even if they exchange only stock for stock.

Notwithstanding these various hurdles, inversions have continued since 2004, and the pace of prospective inversion activity has increased dramatically of late, particularly for large public US corporations. Several corporations have completed successful inversions: in the pharmaceutical sector alone, Perrigo partnered with Elan, Actavis with Warner Chilcott, and Endo with Paladin Labs. Equipment manufacturer Applied Materials agreed to merge with Tokyo Electron (as discussed above), and drug developer Horizon Pharma signed a deal with Vidara. Inversions made front-page news in the summer of 2013, when advertising giants Omnicom and Publicis signed a merger agreement that would have created the world's largest advertising conglomerate, although negotiations eventually fell apart. More recently, Pfizer's pursuit of AstraZeneca became public in April 2014. AstraZeneca, a British public limited company, would have provided Pfizer with the opportunity to complete one of the largest inversions ever, but Pfizer's pursuit failed, at least for the foreseeable future, in late May. Other US companies are being forced to consider inverting, either implicitly by market trading multiples that lag those applicable to foreign companies or explicitly by activist investors.

In the wake of all of this, the IRS and lawmakers are clearly struggling to keep up.

New Regulations under Section 7874

In January 2014, the IRS issued temporary regulations under Section 7874 that are designed to combat manipulation of the inverted foreign company's ownership. Under the language of Section 7874, any stock in the foreign company would be disregarded if it was issued in a 'public offering'. This rule was designed to prevent a foreign corporation from issuing large amounts of stock for cash before participating in an inversion that would have failed to qualify as a valid inversion if the stock had not been issued. The new regulations effectively supersede this rule and create a broad 'anti-stuffing' rule that applies without regard to whether a 'public offering' has occurred.

When testing US ownership percentages under Section 7874, the temporary regulations disregard stock that is exchanged for cash, cash equivalents, or marketable securities. This rule prevents corporations from manipulating these ownership percentages through transactions that mimic the effect of issuing stock for cash in a public offering. The new regulations also include an anti-abuse rule that disregards any stock exchanged with a principal purpose of avoiding the purposes of Section 7874.

Proposed Amendments to Section 7874

The Obama administration (in the Treasury Department's Fiscal Year 2015 Revenue Proposal) and Democratic members of both houses of the US Congress have proposed changes to Section 7874. These proposals would eliminate the rules limiting use of tax attributes to shield income arising from post-inversion restructurings, but they would also reduce the ownership threshold necessary to avoid treatment as a domestic corporation from 80 per cent to 50 per cent. In other words, the 80 per cent/20 per cent test would change to a 50 per cent/50 per cent test: if the foreign corporation does not have substantial business activities in its home jurisdiction, then it will be treated as a US corporation if, after the inversion, historic shareholders of the US corporation own 50 per cent or more of the foreign corporation's stock.

In addition, even if the 50 per cent test were satisfied, the proposed rules would nevertheless treat an inverted foreign corporation as a domestic corporation if the foreign corporation's group has substantial business activities in the United States and is primarily managed and controlled in the United States. This addition would prompt a major shift in how inverted companies operate because many inverted companies continue to operate large US businesses and their US-based executives generally continue to live and work in the United States. Many observers have also noted with astonishment that this would preclude any foreign company primarily managed and controlled in the United States (whether or not it had previously inverted) from acquiring US companies (even small ones) for stock, lest the foreign company become suddenly treated as a domestic corporation.

The effective dates of the various proposals vary widely. The Obama administration proposed its rules in January 2014, effective for any inversions occurring after 31 December 2014. Since then, however, the debate about inversions has heated up dramatically, and the Congressional proposals include the unusual feature of retroactivity: they would apply to inversions occurring after 8 May 2014. This means that companies considering inversions will be forced to proceed with inversions using great caution and, presumably, only on the expectation that any final legislation will not apply retroactively. In addition, the proposal in the US Senate would apply the new rules only for two years. The theory

is to place a moratorium on many inversions until Congress is able to address more comprehensive tax reform. The proposal in the US House of Representatives does not contain this feature.

'Killer Bs' and the Avoidance of Shareholder-Level Gain on Inversions

As mentioned above, in most recent inversions, the historic shareholders of the US corporation are forced to recognise gain (but not loss) if they own more than 50 per cent of the foreign corporation after the inversion, even if they exchange stock for stock in the transaction. Under normal circumstances, a stock-for-stock exchange would qualify for non-recognition, but the regulations under Section 367 of the US Tax Code change this result – forcing gain recognition and denying loss recognition – when the US corporation is larger than the foreign target.

In general, the existence of the shareholder-level tax has not chilled inversions. Quite the contrary, public US companies that have announced inversions have generally seen broad approval from the public markets in the form of increases in the companies' stock prices. The long-term benefits of inverting often are expected to outweigh the immediate cost of accelerating shareholder-level tax.

On the other hand, US individuals who hold large blocks of stock in US companies (such as founders) care quite a bit about the shareholder-level tax. Some of those companies have inverted, too, but have attempted to structure their inversions to fit into an exception to shareholder-level gain recognition, even where the shareholders of the US corporation owned more than 50 per cent of the stock of the foreign corporation after the inversion.

These companies' inversion structures have included the distribution of a promissory note from the US merger subsidiary to its foreign parent before the US merger subsidiary merged with the US target corporation. The note would trigger little tax liability in the inversion itself – for example, the distribution would constitute a dividend (subject to US withholding tax) only to the extent the US merger subsidiary had current or accumulated earnings for US tax purposes. Because the merger subsidiary was recently formed, it often had little accumulated earnings. But, the rules governing such note distributions render inapplicable the rules regarding shareholder-level gain recognition under Section 367 – even though the total US tax incurred on these distributions is minimal – and so the companies that have structured transactions to fit within these rules have taken the position that the shareholder-level tax does not apply. Moreover, the subsequent repayment of these notes would potentially enable the US corporation to distribute earnings and profits to the foreign parent without incurring future US tax while enjoying additional interest deductions that could actually lower future US tax liability.

On 25 April 2014, the IRS issued Notice 2014-32, in which it rejected such claims by taxpayers and took the position that the shareholder-level tax under the Section 367 regulations cannot be avoided by using such strategies. In addition, the IRS made clear that the new rules would require the merger subsidiary to take into account the US target corporation's current and accumulated earnings in addition to its own, thus assuring that the distribution of a note would result in a larger upfront tax cost.

Like Section 7874 itself, the new rules contemplated by the notice will likely not stop the inversion frenzy. They will simply make inversions more costly to implement

in the first place. In this sense, they should be viewed as increasing the 'toll charge' applicable to companies seeking to invert.

Proposed rules under Section 381

Under Section 381 of the US Tax Code, an acquiring corporation in certain asset acquisitions succeeds to the tax attributes of the corporation that transfers the assets. The regulations define the 'acquiring corporation' as the corporation that ultimately acquires all the assets transferred. If no single corporation ultimately acquires all of the assets transferred, the acquiring corporation is the corporation that directly acquires the assets transferred from the transferor corporation, even if most of the assets are subsequently transferred to another corporation.

These rules have historically allowed corporations to elect which entity will receive the tax attributes in asset reorganisations. For example, consider a reorganisation in which the recipient corporation that directly receives assets transfers all of the assets to a single controlled subsidiary. The recipient corporation could choose to retain a single asset, which would cause the tax attributes to stay with the recipient corporation; alternatively, it could transfer all of the assets to the controlled subsidiary, which would cause the tax attributes to pass to the subsidiary.

On 7 May 2014, the IRS proposed rules to limit this electivity.[153] The new rules would amend the regulations to define the acquiring corporation as the corporation that directly acquires the assets transferred. Even if the corporation that directly acquires the assets retains none of them, it would still be the acquiring corporation. The IRS reasoned that, in addition to eliminating electivity, this approach would reduce the administrative burden associated with determining whether or not a corporation has acquired all of the assets transferred. The agency also emphasised that the proposed rules would appropriately place the transferor corporation's earnings and profits in the corporation nearest to the former shareholders of the transferor corporation.

The proposed Section 381 regulations, if finalised, would simplify the manner in which tax attributes transfer from a seller to an acquiring group in an asset reorganisation. (The preamble to the proposed regulations makes clear that the same rules would apply for purposes of allocating earnings and profits.) Although taxpayers would forgo some degree of electivity, they would also benefit from the certainty of knowing exactly which corporation constitutes the 'acquiring corporation' under Section 381. Perhaps most importantly, the proposed regulations will, if finalised, require corporate buyers to take tax attributes into account when structuring their acquisitions; it would no longer be possible for a buyer to wait until after the asset reorganisation is complete to shift the newly acquired tax attributes within its corporate structure.

Conclusion

Most observers predict that the gridlock in Washington is unlikely to end anytime soon. In the meantime, the frenzy of inversion activity is likely to continue and even increase as companies seek to complete transactions before the United States changes its rules again.

153 Notice of Proposed Rulemaking, Fed. Reg. Vol. 79, No. 88 p. 26190 (7 May 2014).

IX COMPETITION LAW

In the past year the Antitrust Division of the Department of Justice (DoJ) and the Federal Trade Commission (FTC, together with the DoJ, 'the agencies') have continued to carefully examine potential anti-competitive effects of all types of transactions, including those that are HSR reportable, non-reportable, pending and consummated.[154] The FTC issued Second Requests in 25 merger investigations during fiscal year 2013 and the DoJ issued 22 Second Requests.[155] Additionally, in November 2013, the FTC issued final changes to the premerger notification rules pertaining to the circumstances under which a transfer of exclusive rights to a pharmaceutical patent results in an HSR-reportable asset acquisition.[156]

In 2013, both the DoJ and FTC demonstrated a willingness to challenge and litigate transactions that raised potential competitive concerns. Both agencies had successful challenges to consummated, non-HSR reportable transactions in the *Bazaarvoice/PowerReviews* and *St. Luke's/Saltzer* transactions, and both reached satisfactory settlements only after commencing litigation in the *US Air/American* and *Ardagh/St. Gobain* transactions. The FTC also demonstrated an openness to changed market conditions in the *Office Depot/OfficeMax* transaction when analysing an industry it previously had examined. Several of these transactions highlighted the crucial role that a company's internal, ordinary-course business documents and data can play when evaluating the business objective of a proposed transaction and likely post-merger anti-competitive effects.

In terms of personnel changes, Terrell McSweeny was sworn in as a Commissioner of the FTC on 28 April 2014, and Deborah Feinstein was named Director of the Bureau of Competition in June 2013.[157] In August 2013, David Gelfand joined the Antitrust Division as the Deputy Assistant Attorney General for Litigation.[158]

154 See Deborah L. Feinstein, Bureau of Competition, Director's Report 2 (Spring 2014), www.ftc.gov/system/files/documents/public_statements/294831/140328springupdatemarch2014.pdf.

155 See id.; see also Edith Ramirez & William J. Baer, Hart-Scott-Rodino Annual Report, Fiscal Year 2013, www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino.s.c.18a-hart-scott-rodino-antitrust-improvements-act-1976/140521hsrreport.pdf.

156 See Press Release, Fed. Trade Comm'n, FTC Finalizes Amendment to the Premerger Notification Rules Related to the Transfer of Exclusive Patent Rights in the Pharmaceutical Industry (6 November 2013), www.ftc.gov/news-events/press-releases/2013/11/ftc-finalizes-amendments-premerger-notification-rules-related.

157 See Press Release, Fed. Trade Comm'n, Terrell McSweeny Begins Term at Federal Trade Commission (28 April 2014), www.ftc.gov/news-events/press-releases/2014/04/terrell-mcsweeny-begins-term-federal-trade-commission; Pres Release, Fed. Trade Comm'n, FTC Chairwoman Edith Ramirez Names Senior Staff (17 June 2013), www.ftc.gov/news-events/press-releases/2013/06/ftc-chairwoman-edith-ramirez-names-senior-staff.

158 Division Update Spring 2014, Meet David Gelfand, www.justice.gov/atr/public/division-update/2014/david-gelfand.html.

i Department of Justice

The DoJ reviewed a variety of high-profile transactions over the last year, most notably the highly publicised merger between US Airways Group, Inc. (US Air) and American Airlines (American). In 2013, the DoJ also litigated and won its challenge to the acquisition by Bazaarvoice, Inc. (Bazaarvoice) of PowerReviews, Inc. (PowerReviews).

US Air/American

On 13 August 2013, the DoJ, joined by six state attorneys general and the District of Columbia, filed suit to block US Air's proposed $11 billion acquisition of American, alleging that the merger would reduce the number of 'legacy' airlines from four to three and facilitate price coordination, rather than competition, between the airlines.[159] The merger to create the world's largest airline had been announced on 14 February 2013. In its complaint, the DoJ focused on US Air's 'maverick' pricing strategy, which utilised 'Advantage Fares' – 'an aggressive discounting strategy aimed at undercutting the other legacy airlines' nonstop fares with cheaper connecting service'.[160] The DoJ alleged that the 'merged airline would likely abandon Advantage Fares, eliminating significant competition and causing consumers to pay hundreds of millions of dollars more'.[161] The complaint also focused specifically on the decreased competition for air carrier service at Washington, DC's Reagan National airport, where the combined entity would hold 69 per cent of government-issued take off and landing rights ('slots').[162] Additionally, the DoJ alleged that the merger would increase the likelihood of coordinated behaviour among the legacy airlines, noting that the structure of the airline industry lends itself to coordinated effects: 'Few large players dominate the industry; each transaction is small; and most pricing is readily transparent.'[163]

Notably, American had filed for bankruptcy at the time of the proposed transaction, but the DoJ's suit made clear that public policy does not dictate that bankruptcy proceedings should trump antitrust concerns. The government maintained that American was capable of emerging from bankruptcy as a standalone company with 'a competitive cost structure, profitable existing business, and plans for growth'.[164] In its complaint, the DoJ quoted an internal document written by a US Air executive vice president which stated that '[t]here is NO question about AMR's ability to survive on a stand-alone basis'.[165]

When the DoJ's lawsuit was announced, news outlets reported that the challenge was 'unexpected by analysts and industry executives' because it 'mark[ed] a sharp break with the Justice Department's past policy, which allowed six unprofitable airlines to merge

159 See Complaint at 3, *United States v. US Airways Group, Inc. and AMR Corp.*, No. 1:13-cv-01236 (D.D.C. 13 August 2013).

160 Id. at 4.

161 Id. at 5.

162 Id. at 6.

163 Id. at 15.

164 Id. at 7.

165 Complaint, *United States v. US Airways Group, Inc. and AMR Corp.*, *supra* note 159, at 9.

over the past five years in an effort to cut costs and end losses'.[166] Continuing in the line of the DoJ's challenge to AT&T's proposed acquisition of T-Mobile in 2011, the complaint shifted its emphasis from the traditional analysis of local, route-specific, non-stop 'origin and destination' markets to a more national market with its focus on competition from US Air's Advantage Fares program and on potential coordinated effects among the three remaining legacy airlines. This departed from the agency's review of the Delta/Northwest merger in 2008 and the United/Continental merger in 2010, at which time the DoJ had included low cost, non-network carriers in the market and had treated nonstop routes as separate markets from connecting routes.[167] In its *US Air* complaint, the DoJ limited the relevant competitors to 'network' airlines with national 'hub-and-spoke' service networks and did not differentiate between nonstop and connecting routes.[168]

After months of negotiation, on 12 November 2013, the DoJ and the airlines reached a settlement whereby US Air and American would 'divest slots and gates at key constrained airports across the country to low cost carrier airlines (LCCs) in order to enhance system-wide competition in the airline industry resulting in more choices and more competitive airfares for consumers'.[169] According to the DoJ, the settlement would increase the ability of LCCs to compete at 'Boston Logan International, Chicago O'Hare International, Dallas Love Field, Los Angeles International, Miami International, New York LaGuardia International and Ronald Reagan Washington National'.[170] In addition, the settlement prohibited the combined entity from reacquiring an ownership interest in any of the divested gates or slots during the term of the settlement.[171] The settlement also required the merged firm to notify the DoJ in the event that it acquires any slots at Reagan National in the future.[172]

On 25 April 2014, US District Judge Colleen Kollar-Kotelly approved the settlement terms, clearing the way for the consummation of the merger.[173]

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166 See Sara Forden, David McLaughlin & Mary Schlangenstein, American Bar Association AMR-US Airways Deal Opposed by U.S. in Antitrust Suit, *Bloomberg*, 13 August 2013, www.bloomberg.com/news/2013-08-13/amr-us-airways-deal-blocked-by-u-s-in-antitrust-suit.html.

167 See Ronan P. Harty & Michael Sohn, *Shifting Paradigms in Market Definition – From Staples/Office Depot to AMR/US Airways*, 14 Amer. Bar Assoc.: The Threshold Newsletter 4-5 (2013).

168 See id. at 6-7.

169 Press Release, Dep't of Justice, Justice Department Requires US Airways and American Airlines to Divest Facilities at Seven Key Airports to Enhance System-wide Competition and Settle Merger Challenge (12 November 2013), www.justice.gov/opa/pr/2013/November/13-at-1202.html.

170 Id.

171 See Proposed Final Judgment at 22, *United States v. US Airways Group, Inc. and AMR Corp.*, No. 1:13-cv-01236 (CKK) (D.D.C. 12 November 2013).

172 Id. at 22-23.

173 See Memorandum Opinion, *United States v. US Airways Group, Inc., et al.*, No. 13-cv-1236 (CKK) (D.D.C. 25 April 2014).

Bazaarvoice/PowerReviews

As discussed in the prior edition, on 10 January 2013, the DoJ filed a civil suit against Bazaarvoice, challenging Bazaarvoice's consummated merger with PowerReviews valued at approximately $168 million.[174] Bazaarvoice, a commercial supplier of product ratings and reviews (PRR) platforms in the United States, acquired PowerReviews, its closest rival, in a non-HSR reportable transaction in June 2012.[175] Thereafter, the DoJ attempted to unwind the acquisition as an anti-competitive merger under Section 7 of the Clayton Act. This lawsuit highlights that even consummated deals below the HSR reporting thresholds continue to be subject to antitrust scrutiny and litigation.

This case also sheds light on the importance of internal documents and the significant role they can play in the government's case. In its complaint, the DoJ cited a document by the CFO of Bazaarvoice acknowledging that there were 'literally, no other competitors' to support its argument that the transaction was a merger to monopoly, and post-merger Bazaarvoice had both the incentive and ability to raise prices.[176] The *Bazaarvoice* case went to trial in the fall of 2013 and was decided in the DoJ's favour on 8 January 2014, with the court holding that Bazaarvoice had violated Section 7 of the Clayton Act 'by purchasing its closest and only serious competitor'.[177] In its decision, the District Court for the Northern District of California remarked that Bazaarvoice's 'defenses were often undermined by pre-acquisition statements from its and PowerReviews's executives. Its portrayal of PowerReviews as a weak and unworthy competitor was belied by the plethora of documents showing that, prior to the merger, Bazaarvoice considered PowerReviews its strongest and only credible competitor, that the two companies operated in a duopoly, and that Bazaarvoice's management believed that the purchase of PowerReviews would eliminate its only real competitor.'[178] The decision quotes extensively from internal documents and deposition testimony of Bazaarvoice and PowerReviews executives that characterised PowerReviews as Bazaarvoice's primary competitor and next closest substitute.[179]

This case was also notable for the lack of weight that the court attributed to customer testimony.[180] While the parties put forth multiple customer witnesses in favour of the transaction who testified to its lack of anti-competitive effects, the court found that customer testimony was 'speculative at best'.[181] The court highlighted that customers

174 Press Release, Dep't of Justice, Justice Department Files Antitrust Lawsuit Against Bazaarvoice Inc. Regarding the Company's Acquisition of PowerReviews Inc., (10 January 2013), www.justice.gov/atr/public/press_releases/2013/291185.htm.

175 Id.

176 Complaint at 3, *United States v. Bazaarvoice, Inc.*, No. 13-0133 (N.D. Cal. 10 January 2013).

177 *United States v. Bazaarvoice, Inc.*, No. 13-cv-00133-WHO, 2014 WL 203966, at *76 (N.D. Cal. 8 January 2014).

178 Id. at *4.

179 Id. at *11-19.

180 See id. at *61-62.

181 Id. at *61. The court's decision not to rely on the views of customers recalls the 2004 Oracle/PeopleSoft merger, in which the same court allowed the merger to go through despite customer

lacked expert economic evidence about the effects of the transaction and many had testified that they had not thought a great deal about the merger or had no opinion about its effects.[182] Others were unaware of alternatives and did not keep up-to-date with the activities within the PRR platform market.[183]

The court held that in light of the significant market share acquired by Bazaarvoice, 'the stark pre-merger evidence of anti-competitive intent and the merger's likely effects, coupled with the actual lack of impact competitors have made since the merger, the government established the Section 7 violation'.[184] In the aftermath of the court's decision, the parties ultimately agreed on a remedy in which Bazaarvoice would divest all of the assets it had acquired from PowerReviews.[185] The remedy also required Bazaarvoice to provide syndication services to the approved divestiture buyer for four years, enabling it to quickly become a viable competitor in the market,[186] and to waive any potential breach of contract claim for any current customer that may choose to switch to the buyer's service.[187] It also committed to waiving any trade-secret restrictions on its current and former employees who may be hired by the divestiture buyer.[188]

ii Federal Trade Commission

The FTC demonstrated its willingness to adapt to changed market circumstances, to settle cases with consent decrees and to take cases to trial in 2013, most notably with the merger between Office Depot, Inc. (Office Depot) and OfficeMax, Inc. (OfficeMax), the acquisition by St. Luke's Health System, Ltd. (St. Luke's) of Saltzer Medical Group P.A. (Saltzer) and the acquisition by Ardagh Group, S.A. (Ardagh) of Saint-Gobain Containers, Inc. (Saint-Gobain).

Office Depot/OfficeMax

On 20 February 2013, Office Depot announced a proposed stock-for-stock merger of equals with OfficeMax, valued at $1.2 billion.[189] The FTC issued a Second Request and conducted a seven-month investigation into the likely competitive effects of the merger between the second and third largest office supply superstores (OSS) in the United

testimony against the merger. See *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

182 See id.

183 Id. at *61-62.

184 Id. at *5.

185 Press Release, Dep't of Justice, Justice Department and Bazaarvoice Inc. Agree on Remedy to Address Bazaarvoice's Illegal Acquisition of PowerReviews (24 April 2014).

186 Id.

187 See Plaintiff's Second Amended [Proposed] Final Judgment at 6, *United States v. Bazaarvoice, Inc.*, No. 13-cv-00133 WHO (N.D. Cal. 24 April 2014).

188 Id. at 5-6.

189 See Scott Flaherty, FTC Takes Closer Look at $1.2B Office Depot-OfficeMax Deal, *Law360* (9 April 2013), www.law360.com/articles/431256/ftc-takes-closer-look-at-1-2b-office-depot-officemax-deal.

States.[190] On 1 November 2013, the FTC unanimously voted to close the investigation and allow the transaction to move forward.[191]

In its closing statement, the FTC discussed its 1997 decision to block a proposed merger between Staples and Office Depot, the nation's two largest OSS.[192] At that time, the FTC argued that the relevant product market was the sale of consumable office supplies by OSS, and had excluded non-OSS competitors from the market definition.[193] In deciding to allow the Office Depot/OfficeMax merger to go through, the FTC noted that the 'current competitive dynamics are very different' due to two primary developments in the market for office supplies.[194] First, non-OSS mass merchants like Wal-Mart and Target have expanded into the office supply market and are significant competitors to dedicated OSS.[195] Second, the 'explosive growth of online commerce' has resulted in intense competition for OSS and has driven OSS to match lower online prices and vigorously compete with internet-based retailers.[196] In both its 1997 and 2013 investigations, the FTC had relied heavily on its econometric analysis. In 1997, the FTC had found that prices were higher in areas with only one OSS, and lower in areas with two or more OSS, indicating that non-OSS did not constrain OSS pricing. However, in the more recent transaction, the FTC noted that the econometric analysis reflected the modern-day competitive dynamics in the office supply market and demonstrated that the proposed merger was unlikely to result in higher prices.[197]

The FTC concluded, 'Our decision highlights that yesterday's market dynamics may be very different from the market dynamics of today.'[198] The FTC's willingness to acknowledge changed circumstances in this case is particularly noteworthy, as its candid recognition of its shift in position demonstrates the fact-specific and constantly evolving nature of antitrust enforcement.

St. Luke's/Saltzer

On 12 March 2013, the FTC and the Idaho Attorney General jointly filed a complaint in the District of Ohio seeking a permanent injunction to unwind St. Luke's acquisition

190 See Statement of the Federal Trade Commission Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc., FTC File No. 131-0104 (1 November 2013), www.ftc.gov/sites/default/files/documents/closing_letters/office-depot-inc./officemax-inc./131101officedepotofficemaxstatement.pdf.

191 See id. at 1.

192 See *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997).

193 See Statement of the Federal Trade Commission Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc., *supra* note 190, at 1.

194 Id.

195 See id.

196 Id. at 1-2.

197 Id. at 2.

198 Id. at 3.

of Saltzer, Idaho's largest independent, multi-specialty physician practice group.[199] St. Luke's had acquired the assets of Saltzer on 31 December 2012 in a non-HSR reportable transaction.[200]

After St. Alphonsus, a competitor health-care system, filed a complaint in federal court in November 2012 alleging that the acquisition violated Section 7 of the Clayton Act, the FTC and Idaho Attorney General followed suit. The FTC alleged that the acquisition would create a single dominant provider of adult primary care physician services in and around Nampa, Idaho, with the combined entity controlling a 60 per cent market share.[201] The complaint highlighted that the acquisition would 'eliminate significant head-to-head competition between the Defendants and therefore increase St. Luke's ability and incentive to demand higher reimbursement rates from commercial health plans'.[202] It also would eliminate an alternative option for health plans if they could not come to mutually agreeable contract terms with St. Luke's – while a network including Saltzer and St. Alphonsus' primary care physicians could compete with St. Luke's and constrain St. Luke's prices, a St. Alphonsus network without Saltzer would not be a viable alternative for local employers.[203] The complaint noted the significant barriers to entry in the relevant market, particularly due to the lack of available adult primary care physicians and the unlikelihood of new practitioners attracting patients who already have an established doctor-patient relationship with a primary care physician.[204]

The *St. Luke's* case went to trial in late 2013, and on 24 January 2014, the federal district court ruled in favour of the FTC, holding that the acquisition violated Section 7 of the Clayton Act and the Idaho Competition Act.[205] The court found that the substantial post-acquisition market share of St. Luke's would give it a dominant bargaining position over health plans and that it was highly likely that St. Luke's would use that market power to receive increased reimbursements which would result in higher premiums and deductibles for consumers.[206] St. Luke's was ordered to fully divest all Saltzer physicians

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

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

201 Id. at 3.

202 Id. at 15.

203 See id. at 16-17.

204 Id. at 21-22.

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

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

and assets and 'take any further action needed to unwind the acquisition'.[207] The court did not, however, require St. Luke's to notify the government in advance of any future transactions with physician groups.[208]

Ardagh/St. Gobain

On 1 July 2013, the FTC sued to block Ardagh's proposed $1.7 billion acquisition of Saint-Gobain, alleging that post-merger, the merged entity and Owens-Illinois, its only remaining significant competitor, would control over 75 per cent of the market in the United States for glass containers for beer and sprits.[209] The FTC alleged that the parties' agreement violated Section 5 of the FTC Act and that the merger between the second- and third-largest US glass container manufacturers, if consummated, would violate Section 7 of the Clayton Act.[210] The FTC had examined and challenged a glass container supplier transaction previously in the 1988 merger of Owens-Illinois and Brockway, at which time the FTC's motion for a preliminary injunction had been denied. There, the court found that 'the alleged inelastic end uses do not support a definition of the relevant product market as 'all glass containers'';[211] instead, the court defined the market more broadly as 'all rigid-walled containers'.[212] Following this decision, the FTC found that collusion was unlikely and dismissed its complaint.[213] In opposing the *Ardagh/Saint-Gobain* transaction, the FTC argued that the industry had changed in the intervening decades, and under the current facts, aluminum cans and plastic containers were not close substitutes for glass containers for beer and spirits and should not be included in the relevant product market.[214] The FTC's administrative complaint detailed the extensive consolidation in the US glass container industry in the last 30 years and highlighted that consumers often pit Owens-Illinois, Saint-Gobain and Ardagh against one another in order to lower prices.[215] The FTC also quoted from the parties' ordinary-course business documents in support of its arguments that competition between the defendants constrained prices and that Saint-Gobain and Ardagh competed on quality and innovation.[216]

207 Memorandum Decision and Order at 4, FTC and *State of Idaho v. St. Luke's Health System, Ltd. and Saltzer Medical Group, P.A.*, No. 1:13-cv-00116-BLW (D. Idaho 24 January 2014).

208 See Findings of Fact and Conclusions of Law, *supra* note 206, at 52.

209 Press Release, Fed. Trade Comm'n, FTC Challenges Ardagh Group, S.A.'s Proposed Acquisition of Rival Glass-Container Manufacturer Saint-Gobain Containers, Inc. (1 July 2013), www.ftc.gov/news-events/press-releases/2013/07/ftc-challenges-ardagh-group-sas-proposed-acquisition-rival-glass.

210 See Complaint at 1-2, In the Matter of Ardagh Group S.A., No. 9356 (FTC 1 July 2013).

211 *FTC v. Owens-Illinois, Inc.*, 681 F. Supp. 27, 54 (D.D.C. 1988).

212 See id. at 46.

213 See Director's Report, *supra* note 154, at 3; see also *In the Matter of Owens-Illinois, Inc. and Brockway, Inc.*, Dkt. 9212, 115 F.T.C. 179 (1992).

214 See Director's Report, *supra* note 154, at 3.

215 Id. at 5-6.

216 Id. at 11-12.

The FTC moved for a preliminary injunction in the District of Columbia federal court, but before the hearing on the motion, the defendants stipulated on 8 November 2013 that they would not consummate the acquisition until the completion of the full administrative action.[217] On 16 December 2013, three days prior to the start of the administrative hearing, the parties filed a joint motion to stay the proceeding in order to pursue a settlement package.[218]

On 10 April 2014, the FTC and Ardagh reached a settlement whereby Ardagh agreed to divest six of its nine glass container manufacturing plants in the United States to an approved single buyer.[219] The FTC noted that the divestiture would create an independent third competitor to offset the lost competition in the beer and spirit glass container markets.[220] Commissioner Joshua Wright dissented from the FTC's decision, stating that the proposed transaction did not violate Section 7 of the Clayton Act, as 'any potential anticompetitive effect arising from the proposed merger is outweighed significantly by the benefits to consumers flowing from the transaction's expected cognizable efficiencies'.[221]

According to FTC staff commentary following the settlement agreement, the *Ardagh* case was particularly 'noteworthy because of the parties' attempt to 'litigate the fix' by restructuring the deal after the Commission challenged the acquisition in court'.[222] Ardagh had filed its brief in opposition to a preliminary injunction on 18 September 2013, and at that time announced its intention to restructure the transaction by selling four glass plants and extending the contracts of specified customers; however, Ardagh did not present a buyer for the assets, nor had the FTC had the opportunity to evaluate the proposed remedy.[223] At the 24 September 2013 pretrial conference, Ardagh argued that its proposed 'fix' should allay any concern about the anti-competitive effects of the transaction.[224] The District court 'ruled that it would be 'premature and precipitous'

217 See id. at 2.

218 See Order Rescheduling Hearing Date and Staying Proceeding, *In the Matter of Ardagh Group S.A.*, No. 9356 (FTC 18 December 2013).

219 See Press Release, Fed. Trade Comm'n, Ardagh Group SA Settles FTC Litigation Charging That Acquisition of Rival Saint-Gobain Containers, Inc. Would be Anticompetitive (10 April 2014), www.ftc.gov/news-events/press-releases/2014/04/ardagh-group-sa-settles-ftc-litigation-charging-acquisition-rival.

220 See Statement of the Federal Trade Commission at 3, *In the Matter of Ardagh Group S.A., Saint-Gobain Containers, Inc., and Compagnie de Saint-Gobain*, File No. 131-0087 (11 April 2014), www.ftc.gov/system/files/documents/cases/140411ardaghcommstmt.pdf.

221 Dissenting Statement of Commissioner Joshua D. Wright at 1, In the Matter of Ardagh Group S.A., Saint-Gobain Containers, Inc., and Compagnie de Saint-Gobain, File No. 131-0087 (11 April 2014), www.ftc.gov/system/files/documents/cases/140411ardaghstmt.pdf.

222 Angelike Andrinopoulos Mina & Jim Abell, The Fix is (Not) In: Lessons from the Ardagh Case, Competition Matters (9 April 2014), www.ftc.gov/news-events/blogs/competition-matters/2014/04/fix-not-lessons-ardagh-case.

223 Id.

224 Id.

for her to hear any evidence related to the proposed four-plant divestiture package' and thus the court would evaluate only the original deal that the FTC had challenged.[225] In their commentary, FTC staff members remarked that while parties may present a divestiture package post-complaint, the package of assets must contain all the necessary elements to interest a potential buyer, or a buyer must be identified up front.[226] The staff noted that the ultimate six-plant divestiture, with accompanying auxiliary mold and engineering facilities, constituted a sufficient 'fix', and '[t]he *Ardagh* case serves as an important reminder that the Commission is willing to litigate if necessary to obtain an effective remedy'.[227]

X OUTLOOK

Many expected M&A to find its pre-financial crisis footing in 2013, but deal inertia continued and despite the abundance of inexpensive financing, M&A activity shuffled along. With the US regulatory landscape changing, it remains to be seen how acquirers, in particular private equity sponsors, will access credit to boost M&A levels. On the one hand, the pieces needed for a strong M&A year are in place: inexpensive credit, increased corporate funds and finite private equity capital reserves, large inventories of portfolio companies that may seek to take advantage of market conditions and healthy equity markets.[228] On the other hand, perhaps it is unrealistic to expect the market to fall back into old habits, with the economic and political environment still shaken from the not so distant past. However, if the first quarter of 2014 is any indication of M&A activity levels for the rest of the year, it appears that confidence has resurfaced and the market has jumped in with both feet.

225 Id.

226 Id.

227 Id.

228 Jeff Golman, '6 Reasons 2014 Will Be a Strong Year for M&A Activity', *Forbes*, 13 January 2014, www.forbes.com/sites/jeffgolman/2014/01/13/6-reasons-2014-will-be-a-strong-year-for-ma-activity/.

Appendix 1

ABOUT THE AUTHORS

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Richard Hall is a partner in Cravath's corporate department and is head of the firm's mergers and acquisitions practice for EMEA. His practice focuses on mergers and acquisitions, corporate governance advice and matters relating to activist defence. Mr Hall's clients have included Archer-Daniels-Midland, Banco Santander, Barrick Gold Corporation, The Linde Group, Shell, Time Warner, Weyerhaeuser and Williams Companies. He has been repeatedly cited as one of the country's leading practitioners in mergers and acquisitions by *Chambers USA*, *Chambers Global*, *The Legal 500 United States*, *The Legal 500 Latin America*, *IFLR1000*, *The Best Lawyers in America*, *Lawdragon's 500 Leading Lawyers in America*, *The International Who's Who of Mergers & Acquisitions Lawyers* and *Latin Lawyer 250*. Mr Hall has been named by *The International Who's Who of Business Lawyers* as one of the ten 'Most Highly Regarded Individuals' in mergers and acquisitions and corporate governance law. Mr Hall received a BComm with honours in 1984, an LLB with honours in 1986 from the University of Melbourne, and an LLM from Harvard University in 1988. He joined Cravath in 1988 and became a partner in 1996.

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