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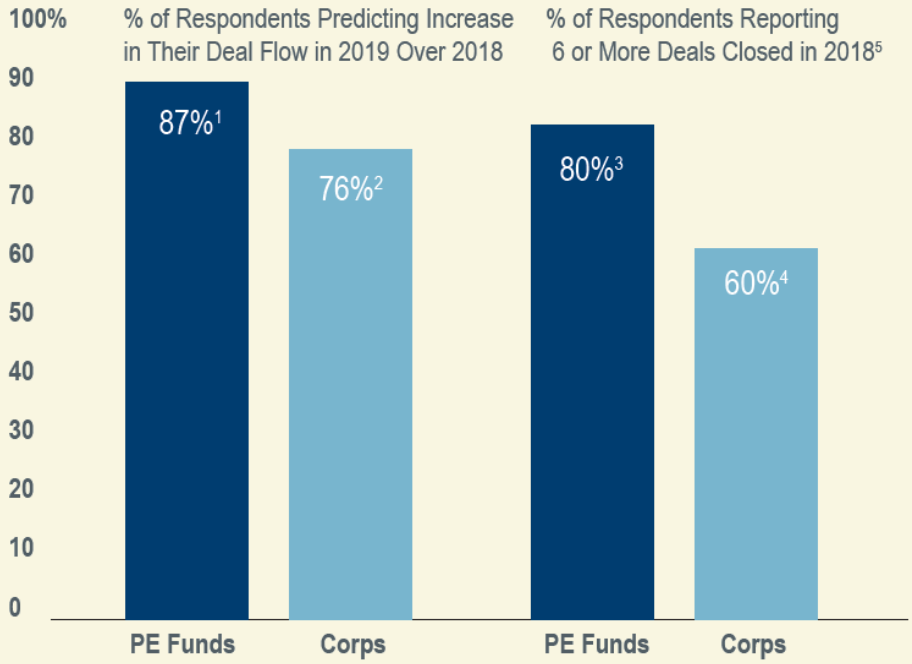
M&A/PE and Governance Update

Posted by Gail Weinstein, Steven Epstein, and David L. Shaw, Fried, Frank, Harris, Shriver & Jacobson LLP., on Tuesday, April 16, 2019

Editor's note: Gail Weinstein is senior counsel, and Steven Epstein and David L. Shaw are partners at Fried, Frank, Harris, Shriver & Jacobson LLP. This post is based on their Fried Frank memorandum, and is part of the Delaware law series; links to other posts in the series are available here.

Number & Size of M&A/PE Deals Are Expected to Increase in 2019

Despite a significant uptick in deal flow from 2017 to 2018, the vast majority of U.S.-based corporate and PE executives expect a further increase in their deal flow in 2019. Further, 70% of respondents predict that deal sizes will be larger in 2019 than 2018.



Data from Deloitte survey of 1,000 executives at a variety of U.S.-based PE Funds and corporations. [1]Up from 76% that expected an increase in 2018 over 2017. [2]Up from 69% that expected an increase in 2018 over 2017. [3]Up from 60% in 2017. [4]Up from 50% in 2017. [5]Further, a majority reported a significant increase in the total value of their deals in 2018 over 2017.

Court of Chancery Enjoins a Controller-Led Merger Pending Corrective Disclosures—*FrontFour v. Medley Capital*

In *FrontFour Capital Group, LLC et al v. Brooke Taube et al [Medley Capital]* (March 11, 2019), the court determined that, based on the precedent set in the Delaware Supreme Court's 2014 *C&J Energy* decision, it could order only a disclosure remedy and not more substantive relief (such as ordering that the company be shopped) in the context of what it viewed as a controller-led merger of three affiliated entities in a "deeply flawed" sale process. The judicial outcome turned on the court's finding that the plaintiff had not proved (indeed, had offered no evidence whatsoever to prove) that the acquiring entity had aided and abetted what the court viewed as fiduciary breaches by the target company's board. Vice Chancellor McCormick indicated that if the plaintiff *had* proved the aiding and abetting claim, then *C&J* would not have precluded the court from ordering a "curative shopping process." The decision may be expected to encourage plaintiffs to make (and try hard to substantiate) aiding and abetting claims to avoid this application of *C&J*.

Financial Advisor and Legal Counsel are Sued for Aiding and Abetting a Target Board's Alleged Fiduciary Breaches—*Morrison v. Berry*

In this longstanding litigation regarding a take-private transaction, the plaintiff, after document discovery, filed an Amended Complaint (made public on March 14, 2019) that added as defendants the target board's highly regarded outside financial advisor and legal counsel. The plaintiff claimed that the advisors aided and abetted the target board's alleged fiduciary breaches in connection with the sale process.

Vice Chancellor Laster Asserts Delaware Jurisdiction Based on Directors' "Sufficient Involvement" in a Merger—and Suggests a New Framework for Analysis in Controller Cases, With Deference to "Enhanced-Independence Directors"—*Pilgrim Pride*

In *In re Pilgrim's Pride Corp. Deriv. Litig.* (March 15, 2019), the Court of Chancery rejected the defendants' motion to dismiss the derivative suit by minority stockholders against the parent company-controller of Pilgrim's Pride Corp. (JBS, S.A., a company organized under the laws of Brazil). The suit challenged Pilgrim's 2017 $1.3 billion acquisition of Moy Park, Ltd., which was owned by JBS. The court disagreed with the plaintiffs' argument that certain Pilgrim directors (all of whom were also executive officers of JBS or its controlled subsidiaries) had not been sufficiently involved in the transaction to be subjected to Delaware jurisdiction. These directors argued that a special committee had been appointed to act with respect to the merger and these directors had only voted on the merger to avoid the triggering of a covenant in the company's debt. According to the court, however, two of these directors actually had been involved in the deal talks. As to the other three directors, the court stated that their only having approved the board resolution approving the deal was a "slim reed" on which to base jurisdiction, but that, at the pleading stage, it constituted "sufficient involvement by conflicted fiduciaries in the effectuation of a self-dealing transaction" to warrant denying their motion to dismiss. The court also asserted jurisdiction over JBS, which had argued that its only contact with Delaware was its

ownership of Pilgrim. The court found that Delaware had jurisdiction over the claims against JBS under a Delaware forum selection bylaw adopted by the Pilgrim board. The court noted that JBS had appointed and exercised control over a majority of the directors on the Pilgrim board and that the board had adopted the forum selection bylaw the same day that it approved the Moy Park transaction.

An interesting aspect of the decision is that Vice Chancellor Laster, citing a recent article by Professors Lucian Bebchuk and Assaf Hamdani (discussed on the Forum here), proposed a possible new framework for evaluating claims in conflicted controller transactions. While a challenged conflicted controller transaction currently is evaluated under the stringent "entire fairness" standard, the Vice Chancellor suggested that perhaps it should be evaluated under the deferential business judgment standard when, as in *Pilgrim Pride*, under the company's corporate governance system, the minority stockholders have the power to elect directors and those directors comprise a majority of the special committee that approved the transaction. This framework would provide another path to business judgement review for controller transactions (in addition to the existing *MFW* framework, which requires that a transaction was, from the outset, conditioned on approval by both an independent special committee and a majority of the minority stockholders). Vice Chancellor Laster observed that, while the *MFW* framework "works well for major transactions like squeeze-out mergers, its significant requirements undermine its utility for other types of interested transactions involving a controller."

The Vice Chancellor explained in the opinion that, based on his knowledge of the Bebchuk-Hamdani article, he had raised *sua sponte* with the parties in *Pilgrim Pride* whether the suggested approach (which he characterized as the "enhanced independence approach") should apply in this case and he had asked the parties to provide supplemental briefs on the issue. In their supplemental brief, the plaintiffs "identified a series of questions of first impression that this court would have to confront, as well as tensions with other areas of Delaware law, and argued that the standard should be applied only in a case where the defendants specifically rely on it and provide the court with full briefing on the subject." The Vice Chancellor agreed that "the current record" in this case did not provide "an adequate basis for assessing the many questions of first impression raised by the enhanced independence approach" (such as whether the "enhanced-independence directors" would in fact be free of the controller's "influence"). He "therefore [did] not consider th[e] approach any further."

Due to the Vice Chancellor's discussion of the proposed approach over two full pages in the body of his opinion, controllers in some cases may consider having a governance system under which some directors are elected by the minority stockholders, with those directors constituting a majority of the special committee evaluating (specific, or all) conflicted transactions between the controller and the company. We note that controlled companies' implementing a structure that would permit application of Laster's suggested standard would be a significant new development. A controller would want to weigh the advantages of obtaining the business judgment safe harbor against the disadvantages of minority-stockholder elected directors controlling the approval process for affiliated transactions.

Delaware Supreme Court Affirms a Dismissal of Claims for Misuse of Trade Secrets by a PE Owner—*Alarm.com*

In *Alarm.com v. ABS Capital Partners* (Feb. 7, 2019), the Delaware Supreme Court upheld a Court of Chancery (June 2018) decision dismissing claims by Alarm.com Inc. that private equity firm ABS Capital Partners, a major investor in Alarm.com with designees on its board, had misused and misappropriated Alarm.com's trade secrets after ABS invested in and joined the board of an Alarm.com competitor. Alarm.com had unsuccessfully sought an injunction to bar ABS from investing in two companies—a startup that was a direct competitor and an industry supplier. The investments occurred about a year after the general partner of ABS left his longtime position as Chairman of Alarm.com's board and the ABS managing partner (who never had served on the alarm.com board) joined the board of the competitor. The Court of Chancery emphasized that unrelated corporate agreements between Alarm.com and ABS made clear that Alarm.com had not negotiated for non-competition commitments from ABS (indeed, the agreements suggested that competition was permitted). The Supreme Court panel emphasized that Alarm.com had advanced a theory of "inevitable use" of trade secrets rather than specific allegations of any actual use. Chief Justice Strine suggested that Alarm.com was "just…upset that [ABS is] a prior private equity sponsor who [Alarm.com] agreed could go into a competing business, and did."

Court of Chancery Finds an Officer-Founder Who Bought a Building Next to the Company's Offices Had Usurped the Company's Corporate Opportunity to Buy It for Expansion Purposes—*Personal Touch*

In *Personal Touch v. Glaubach* (Feb. 25. 2019), the Court of Chancery held that EG, the founder and President of Personal Touch Inc. (a closely held corporation engaged in providing home healthcare services), usurped a corporate opportunity when he personally acquired a building next door to the company's offices in Jamaica, Queens and then rented the building to the company. The company had been wanting to acquire the building to expand its space. Two months after EG acquired the building, the company terminated his employment for that and other reasons. The company then brought suit seeking (i) a declaratory judgment that the termination of EG's employment was valid under his employment agreement and (ii) damages for alleged breaches by EG of his fiduciary duties, including a usurpation of corporate opportunity by his acquiring the building. The suit involved, in the court's words, a "wide-ranging mishmash of issues" relating to cross-allegations of illegality, self-dealing and harassment in the running of Personal Touch.

The court held that EG had usurped a corporate opportunity. By hiding his actions from the company and putting his personal interests ahead of the company's corporate interests, he had intentionally breached the duty of loyalty, the court held. The court awarded the company damages of $2,735,000 (which represented the difference between the building's market value at the time of the trial and the price that EG had paid for it). The court also granted the company a declaration that its terminating EG was valid under his employment agreement, which provided for termination in the event of EG's "willful misconduct." The court stated that the usurpation of corporate opportunity constituted "willful misconduct," "material dishonesty" and a "material breach of trust" under the agreement.

The key part of Chancellor Bouchard's decision is his clarification that the four-part analysis set forth in *Broz*—the critical case in determining whether there has been a usurpation of corporate opportunity—is to be conducted with each of the factors "weighed…on a holistic basis." The court emphasized that the analysis is not to be "technical" or "narrow" but, rather, is to be based on "broad considerations of corporate duty and loyalty," with "a balancing of the equities of [the] individual case."

In *Broz* (1996), the Delaware Supreme Court, relying on its seminal *Goth v. Loft* decision (1939), articulated that a corporate director or officer may not take a business opportunity for his or her own if (i) the corporation is financially able to exploit the opportunity; (ii) the opportunity is within the corporation's line of business; (iii) the corporation has an interest or expectancy in the opportunity; and (iv) by taking the opportunity for his or her own, the corporate fiduciary will thereby be placed in a position inimical to his or her duties to the corporation. The court wrote that, although the *Broz* test is stated "in the conjunctive," *Broz* and later cases emphasize that the test involves a *weighing* of the four factors, "with no one factor [being] dispositive and all [of the] factors [being] taken into account insofar as they are applicable."

The court found, first, that the record established that the company had been "keenly interested in, and had a reasonable expectation of" acquiring the building right up through the time that EG acquired it and was financially able to do so. Second, the court rejected EG's contention that, because the company was a home healthcare business, not a commercial real estate venture, acquisition of the building was not within the company's line of business. The court stated that the line of business inquiry is to be applied "flexibly" such that an opportunity to acquire a building with a highly desirable location that could be used to expand operations is an opportunity that "fits within the Company's existing line of business." An "equally sensible" view, the court wrote, would be to view the line of business factor as "simply not relevant" in a case where, as here, the company had "a clear interest and expectancy" in acquiring the building and "the opportunity presented concern[ed] an operational decision about how to manage or expand [the] existing business." Finally, the court found that taking the opportunity to buy the building placed EG in a position "inimical to his duties"—that is, his taking the opportunity resulted in a conflict between his fiduciary duties to the corporation and his own self-interest "as actualized by the exploitation of the opportunity." The court observed that EG knew of the unique value of the building to the company given its location, knew of the company's interest in and expectancy of acquiring the building, concealed his activities with respect to the building from the company until after he had closed the deal, and sought to lease the building to the company almost immediately after he acquired it.

Delaware Supreme Court Upholds the Non-Dismissal of Claims Against a Controller for Self-Dealing—*Straight Path*

The Delaware Supreme Court, in a one-page order (issued Feb. 22, 2019), upheld the Court of Chancery decision that allows a suit by two minority investors in Straight Path Communications Inc. against the controlling stockholder to proceed. The plaintiff-stockholders alleged that HJ, the controller of Straight Path's controlling stockholder IDT Corp., had secured personal benefits for himself in the $3.1 billion merger between Straight Path and Verizon. In 2013, IDT had spun Straight Path off and IDT agreed to indemnify the spun-off entity for any regulatory liabilities arising from conduct that occurred prior to the spinoff. Subsequently, an FCC investigation

resulted in a $614 million penalty relating to pre-spinoff fraudulent reporting activities (and thus the fine would have been covered by the indemnification agreement). The minority investors filed suit in July 2017, alleging that HJ had exerted his control over both IDT and Straight Path to avoid the indemnification by refusing to approve any merger that would have included a sale of the claim. Instead, at the same time as the $3.1 billion sale of Straight Path to Verizon in May 2017, Straight Path, had settled the $614 million claim by accepting

$10 million from IDT and selling its intellectual property to HJ for $6 million. In June 2018, Vice Chancellor Glasscock refused to dismiss the plaintiffs' claims, finding that they had adequately pled that they were harmed by the settlement with IDT when they could have retained the indemnification claim as part of a litigation trust that would have survived the Verizon deal. The Supreme Court upheld that decision, rejecting IDT counsel's contentions during oral argument that the claims against HJ, to the extent valid at all, were derivative and therefore belonged to Straight Path and could not be asserted directly by the minority investors.

Board Diversity Is Expected To Be a Focus in the 2019 Proxy Season

It is expected that gender and racial diversity issues will play a key role in the 2019 proxy season. Proxy advisor Glass Lewis announced in late 2018 that, for meetings held after January 1, 2019, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members. Glass Lewis may extend this recommendation to vote against other nominating committee members depending on several factors, including the company's size, industry and governance profile. Glass Lewis's new policy does not necessarily apply to companies outside the Russell 3000 index or those that have provided a robust explanation for not having any female board members.

Other developments on diversity. In this connection, California recently required that publicly held companies based in California have at least one female director by the end of 2019 (and, depending on the size of the board, additional female directors by the end of 2021). Bills are being introduced in New York and New Jersey that would require companies to disclose data on dive. In addition, institutional investors including State Street, CalPERS and BlackRock, have made public demands for greater gender diversity on boards. The Spencer Stuart Board Index, an annual survey on board composition at S&P 500 companies, reported that, in 2018, 40% of new board seats went to female directors; and women now represent 24% of all S&P 500 directors (up from 16% in 2008). Minority men represented only 10% of new board seats in 2018 (down from 14% in 2017). Minority men and women now represent 17% of directors in the top 200 of the S&P 500 (up only slightly from 14% in 2008).

Shareholder Resolutions on Board Gender Diversity. On a related note, Arjuna Capital, an investment firm specializing in sustainable and ethical investing, is engaged in a campaign to induce twelve banks and technology companies to disclose their median pay gaps for women (a number that arguably indicates the extent of underrepresentation of women in higher paying positions at a company). In response, Citigroup disclosed on January 16, 2019 that median pay at the company for women globally was 71% of the median pay for men. Citigroup disclosed further its goals to increase, by the end of 2021, representation at the assistant vice president through managing director levels to at least 40% for women on a global basis and 8% for black employees in the U.S. Arjuna has been orchestrating shareholder resolutions requiring the disclosure, which would be voted on at the companies' 2019 annual meetings. Wells Fargo and

Bank of America both tried to block the resolutions, arguing that they are an attempt to "micromanage" the company; however, on February 21, 2019, the SEC staff disagreed and permitted the resolutions. MasterCard's request to block the resolution it received is pending at the SEC.

New SEC C&DI on Board Diversity Disclosure. The Division of Corporate Finance released Compliance and Disclosure Interpretations 116.11 and 133.13 on February 6, 2019, which address the disclosure of self-identified diversity characteristics with respect to board members and nominees under Regulation S-K, Items 104 and 107. They provide that, to the extent a company's board nominating committee considers self-identified diversity characteristics such as race, gender, ethnicity, religion, disability, sexual orientation or cultural background, the SEC would expect the company's disclosure to include "identifying those characteristics and how they were considered."

Companies Should Consider Designating a Particular EU Subsidiary or Entity as the Company's "Main Establishment" for the Processing of EU Personal Data—*Google*

In its first enforcement action under the EU's General Data Protection Regulation, the French data protection authority ("CNIL"), on Jan. 21, 2019, imposed a €50 million (about US$56.8 million) penalty against Google LLC for violating disclosure and consent requirements under the GDPR relating to the processing of users' personal data for the purpose of developing targeted advertising. Google has announced that it will appeal the decision to France's highest Administrative Court. (The highest fine previously imposed under the GDPR was €400,000, in December 2018. Notably, for certain violations, the GDPR provides that the maximum fine is the *higher* of €20 million or 4% of the entity's annual revenue.) CNIL alleged that, while Google had disclosed a significant volume of data processing information to its users, it had failed (i) to provide notice in an easily accessible form, using clear and plain language, and (ii) to obtain users' valid consent to process their personal data for the purpose of developing personalized advertising. CNIL contended that Google's disclosure was not easily accessible for users and was spread across various documents; and that the description of the purposes of use of data, and the type of data that would be used for these purposes, was too "generic and vague."

Of note, Google had argued that France does not have jurisdiction over it under GDPR. The GDPR provides a "one stop shop" mechanism for companies that operate in multiple EU countries. The country where the company has its "main establishment" in the EU has primary responsibility for enforcement. Google contended that Ireland had jurisdiction because the company's Irish subsidiary is its main establishment in the EU—as it has been the headquarters for the company's EU operations since 2003, oversees administrative and financial functions for Europe region, and is the signing party on all contracts with advertising agencies located in the EU. CNIL took the position that Google had not established any "main establishment" with respect to the processing of personal EU data and that, therefore, CNIL (or *any* other EU authority) had jurisdiction under the GDPR. Based on the evidence provided by Google, CNIL determined that the Irish subsidiary had decision-making authority only with respect to Google's financial, advertising and commercial functions in the European region and had not been identified in Google's privacy policy as the company deciding the means and purposes of processing personal data in the EU. Accordingly, to avoid uncertainty as to which jurisdiction will

have authority under the GDPR, a company should consider specifically assigning authority to a particular EU subsidiary or entity to act as its "main establishment" for the processing of EU personal data and should identify that entity in its privacy policy.

HSR and Director Interlock Thresholds Are Adjusted

The Federal Trade Commission announced on Feb. 15, 2019 the annual update of reporting thresholds for mergers and acquisitions under the Hart-Scott-Rodino Antitrust Improvements Act and director interlock prohibitions under Section 8 of the Clayton Act. The HSR threshold is revised annually based on the annual change in gross national product. The minimum size of a transaction requiring an HSR filing has been raised to $90 million (up from $84.4 million). The revised threshold is applicable to all transactions that close on or after April 3, 2019. The interlocking directorate thresholds prohibit a person from serving as a director or officer of competing corporations unless the parties' sales of the competing products or services are below certain *de minimis* thresholds. Under these revised thresholds, which are effective immediately, simultaneous service as a director or officer of two corporations, each with capital, surplus, and undivided profits of $36,656,400 or more, will be prohibited (subject to several exceptions). Companies should keep in mind that effective Section 8 compliance requires that a corporation annually review the outside affiliations of its directors and officers to assess whether, for example, sales growth, entry into new markets, or a decline in sales or exit from a non-competing business may trigger potential issues under the statute. For further discussion, including the other adjustments made, see our Briefing, *FTC Revises Thresholds for HSR Filings and Interlocking Directorates* (Mar. 4, 2019).

The complete publication is available here.