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M&A/PE QUARTERLY

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A quarterly round-up of key M&A/PE developments

August 2018

1H 2018 M&A/PE Highlights

(Based on data from Mergermarket)

Increase in Global Activity

Global M&A activity in 1H 2018 reached $1.94 trillion in value, an increase of over 28% from 1H 2017. The value in 2Q 2018 was $1 trillion, a more than 9% increase over 1Q 2018.

Increase in US and Europe Activity

The majority of the global increase has been driven by deals in the US and Europe. Almost 73% of global value was in US and European deals, up from 65% in 1H 2017.

Increase in "Mega-Deals"

There were 26 "mega-deals" (deals over $10 billion in value) announced, while there were only 30 in all of 2017.These included 6 deals announced in 2Q 2018 that were over $20 billion.

Increase in PE Buyouts

The value of PE buyouts was $271.7 billion, the highest year-to-date value on record.

Decrease in M&A Litigation in 2017

(Based on data from Cornerstone Research

Decrease in M&A Litigation

The number of deals (valued over $100 million) that were challenged by shareholders declined from an average of 139 during the 2013-2016 period (137 in 2016) to 112 in 2017. The percentage of deals challenged fell from a 2013-2016 average of 84% (71% in 2016) to 73% in 2017.

Decrease in Number of Lawsuits Filed per Deal

The average number of suits filed per transaction declined from 4.2 over the 2013-2016 period to 2.8 in 2016 and in 2017.

Increase in Number of Lawsuits Voluntarily Dismissed

The average number rose from 26% over the 2013-2016 period, to 39% in 2016 and 52% in 2017.

Shift from State to Federal Venues:

There was a 20% increase from 2016 in the number of deals challenged in federal courts. At the same time, the number of M&A deals litigated in Delaware state courts declined by 81%; and the number in California state courts also declined by 81%. The percentage of suits challenging deals with Delaware corporations that were filed in Delaware state court fell to 6% of litigated deals (from 23% in 2016).

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Selected Key Developments in the Second Quarter of 2018

Notable decisions issued in the second quarter of 2018 (discussed below) include:

- ***MFW*-related decision**: One of the few decisions in which the Court of Chancery has addressed the distinction between "negotiations" and "preliminary discussions" for purposes of determining whether the *MFW*-required procedural protections were imposed "before any negotiations took place" *(Olenik)*;

- **Tender offer disclosure:** The first time that any court has allowed a claim under the "anti-fraud rule" applicable to tender offers to proceed without a showing of fraudulent intent *(Emulex)*;

- **Advance notice bylaws:** A rare instance of a court upholding a company's rejection of a shareholder nomination petition based on the shareholder's failure to have provided all of the information required under the company's advance notice bylaw *(Blue Lion)*; and

- **Appraisal:** Reflecting the ongoing uncertainty with respect to appraisal results, (i) a Delaware Supreme Court ruling affirming the unusual result of a well-below-the-deal-price appraisal determination in the context of a controller transaction *(Sprint)*; (ii) a Court of Chancery ruling by Vice Chancellor Laster that reinforces his view that the unaffected market price (rather than the deal price) usually is the best market-based indicator of appraised fair value in arm's-length mergers involving an efficient market *(Aruba)*; (iii) a Court of Chancery decision rejecting both deal price and the unaffected market price, and reaching an above-the-deal-price result, in a case involving an arm's-length merger with what the court viewed to be a "seriously flawed" sale process *(Norcraft)*; and (iv) a Court of Chancery decision that suggests that, in the context of an arm's-length merger with a sale process that was not seriously flawed, reliance on the deal price *less synergies* will now be the standard approach (which will lead to below-the-deal-price results in these cases) *(Solera)*.

MFW-RELATED DECISION

The Court of Chancery Found that *MFW* Approval Conditions Were Imposed from the Outset of "Negotiations," Notwithstanding that "Extensive Preliminary Discussions" Preceded Their Imposition—*Olenik v. Lodzinski* (July 20, 2018). Earthstone Energy, Inc. acquired Bold Energy LLC pursuant to an all-stock merger in which the Earthstone legacy stockholders received 39% of the resulting company. EnCap, a private equity firm, beneficially owned 41% of Earthstone through its ownership of Oak Valley (a holding company for oil and gas investments). EnCap also owned 96% of Bold. The Earthstone board was comprised of nine directors, five of whom were senior executives of Earthstone and/or were serving on the boards of Encap and/or Oak. Two directors, who were viewed by the court as independent and disinterested, comprised the special committee formed to evaluate the proposed transaction on behalf of Earthstone. Both before and after formation of the committee, the lead negotiator for Earthstone was "L," who was a director and the CEO and Chairman of Earthstone and was also the founder and past CEO of and a membership unit holder in Oak. The transaction was approved, on Earthstone's side, by the special committee and (with 84% of Earthstone's outstanding shares voting) by 99.7% of the Earthstone shares voting that were unaffiliated with Earthstone management or Oak.

The plaintiff's main contention was that the transaction should be evaluated under the "entire fairness" standard because, although the transaction was conditioned on approval by an Earthstone independent committee and a majority-of-the-minority vote of Earthstone stockholders, these conditions were not in place *from the outset of the negotiations* as required under *MFW* for business judgment review of a controller transaction. The conditions were not mentioned during ten months of discussions between the parties but were then included in the "Offer Letter" sent by Earthstone to Bold. The court emphasized the "important distinction" between, on the one hand, "preliminary discussions" for the purpose of "exploring" a potential transaction and, on the other hand, "negotiations" for the purpose of arriving at an agreement after a definitive proposal is made. The court held that the Offer Letter represented the "first definitive proposal" made and that, therefore, the *MFW* "*ab initio*" requirement (*i.e.*, that the required conditions be imposed "before any negotiations take place") had been satisfied notwithstanding that there had been "extensive" preliminary discussions before the conditions were imposed. (Given its finding that the prerequisites to the application of *MFW* business judgment review were satisfied, the court found it unnecessary to address the issue whether Oak was actually a controller.)

The ten-month period of discussions had included data room access and management presentations; valuations by bankers; a "non-binding presentation" by Earthstone to EnCap that outlined Earthstone's view of the ownership split for the resulting company based on Earthstone's equity valuation of Bold, and then a revised presentation based on an updated equity valuation; meetings between Earthstone and the banker for Bold to discuss the relevant asset and divestiture markets and likely market reaction to a deal; discussion with EnCap of a timeline, the "suggested plan of action," and the assignment of responsibilities for completion of a transaction; several meetings between Earthstone's directors or management and Bold's CEO; and the special committee's formation, engagement of advisors, and numerous meetings.

The court observed that the purpose of the requirement that the *MFW*-required conditions be imposed "*ab initio*" is to ensure that the deal structure truly "mimic[s] arms-length dealing, and to neutralize the controller's influence." In most instances, the court stated, "'negotiations' begin when a proposal is made by one party which, if accepted by the counter-party, would constitute an agreement between the parties regarding the contemplated transaction." Using this point in time ensures that the controller is "disabled" for purposes of the negotiations and cannot "dangle" a majority-of-the-minority vote before the target company's special committee late in the process "as a deal-closer rather than having to make a price move." The court state that the Offer Letter "announced and made clear from the outset—at the start of negotiations on the proposal" that any transaction between the parties would be subject to the *MFW*-required conditions—and "[t]his is precisely what *MFW* requires." L's discussions with EnCap and Bold "while extensive, never rose to the level of bargaining; they were exploratory in nature," the court stated. The court viewed the Offer Letter as "the first real move in the negotiating bout." The court noted (in a footnote) that the special committee "met several times to formulate its proposal before the Offer Letter was submitted," and, after the Offer Letter was delivered, "the special committee and Bold engaged in substantial negotiations [over a period of two months] before reaching agreement."

Further, the court was not troubled by the role of L as the lead negotiator with Bold and EnCap notwithstanding his close relationships with them. The court stated: "While [L] did engage directly with Bold and EnCap, it can hardly be viewed as remarkable that a chairman and CEO with [L]'s proven track record and expertise in the oil and gas industry would have exploratory discussions with a potential merger partner before the formation of the Special Committee and then spearhead negotiations of the merger on behalf of the Special Committee after it was formed." Importantly, the court found that the special committee had acted with due care—the committee "acted swiftly, diligently monitored the negotiations and actively deliberated the terms of the Transaction with the guidance of its independent advisors early on and throughout the process," the court stated in a footnote. Further, the court rejected the plaintiff's contention that the committee had "rubber-stamp[ed] a fully-baked deal that [L] had negotiated." The court pointed to the fact that, before the Offer Letter was submitted, the special committee had revised Earthstone management's initial equity valuation for Bold (from $335 million to $325 million) and had revised Earthstone's proposed legacy equity ownership (from 38% to the 45% proposed in the Offer Letter).

The decision highlights the potential utility of an *MFW* structure even if extensive exploratory discussions have already occured.

CONTROLLERS

In re Hansen Medical, Inc. S'holders Litig. (June 18, 2018). The Court of Chancery, at the pleading stage, rejected the defendants' motion to dismiss, after finding that the facts pled established that it was "reasonably conceivable" (the applicable standard at the pleading stage for a motion to dismiss) that (i) a group of significant stockholders that collectively owned more than 50% of Hansen's outstanding shares constituted a control group and (ii) these stockholders had used their control of the company to negotiate a beneficial deal for themselves at the expense of the other stockholders in connection with the company's negotiation of its sale to a third party. The court emphasized that it is difficult to determine at the pleading stage of litigation whether stockholders are acting as a group and have control because the answer necessarily depends on a fact-intensive inquiry. The court concluded that the facts pled established that it was reasonably conceivable that the stockholders here were acting as a group given their having entered into various agreements simultaneously, in combination with their 21-year history of collaborating on investments and acting as a group. The court also found that these stockholders received different consideration in the merger than the other stockholders, as they had the opportunity to, and did, roll over their equity in the deal. Based on these conclusions, the court declined to dismiss the plaintiffs' claims at the pleading stage and ruled that "entire fairness" would be the applicable standard of review. For discussion of other issues relating to who is a controller, see **here** our M&A/PE Briefing, *When a Minority Stockholder Has Truly "Outsized Influence," Its Self-Interested Transaction May Be Subject to Entire Fairness Notwithstanding a Special Committee Process—And Other Points from Controller Decisions Issued in 1Q 2018*—Rouse, Tesla, Oracle, NEA (Apr. 11, 2018).

DISCLOSURE

For the First Time, a Court Allowed a Claim Under Section 14(e) (the "Anti-Fraud Rule" Applicable to Tender Offers) to Proceed Without a Showing of Scienter—*Varjabedian v. Emulex* (Apr. 20, 2018). The Ninth Circuit deviated from the holdings of five other Circuit courts and held that claims brought under § 14(e) of the Securities Exchange Act of 1934 do not require proof of scienter (fraudulent intent) and instead require only a showing of negligence. The panel decision found that the earlier rulings by the other five Circuits were flawed interpretations of the plain language of § 14(e) and that US Supreme Court precedent addressing other federal securities provisions supports the conclusion that negligence is the standard for § 14(e) liability. Emulex has filed a petition for rehearing *en banc* by the Ninth Circuit and the plaintiffs have filed a response. For further discussion, please see **here** *Ninth Circuit Creates Circuit Split by Holding that Section 14(e) Claims (Arising in Tender Offer Situations) Do Not Require Allegations of Scienter,* Fried Frank Securities Litigation Update (Summer 2018). The decision highlights the importance of adequate disclosure in tender offer documents and makes it likely that securities action plaintiffs will now seek to file § 14(e) claims in the Ninth Circuit when possible (as the negligence standard will make it more difficult for defendants to obtain dismissal at the early pleading stage of litigation).

The Tenth Circuit Dismissed a Securities Fraud Claim that Was Based on an Alleged Failure to Disclose Merger Discussions—*Employees' Ret. Syst. of Rhode Island v. The Williams Companies* (May 11, 2018). A three-judge panel of the Tenth Circuit Court of Appeals affirmed the dismissal of a securities fraud action based on Williams' not disclosing at a presentation to analysts that it was in merger talks with ETE. Williams had proposed an acquisition of the 40% of the interests in Williams Partners LP ("WPZ") that it did not already own. The plaintiff, on behalf of investors who acquired WPZ partnership interests after Williams announced the proposed merger with WPZ at the presentation to analysts, claimed that they had paid an excessive price, as the price of WPZ interests dropped more than 7% when, a month after the analysts presentation, Williams announced that it was merging with ETE. The plaintiff claimed that Williams had misled the investors by suggesting at the presentation that the WPZ merger was a "done deal" and by not having disclosed that Williams was engaged in merger talks with ETE (which talks, if successful, would result in there being no Williams-WPZ merger).

The court, noting that Williams had made no statement about the possibility of a merger with any party but WPZ, ruled that nothing that the Williams defendants said at the presentation was inconsistent with Williams having received overtures from ETE about a merger. A disclosure that Williams was engaged in talks with ETE "would not 'alter[] the meaning' of any of the statements made about the Williams-WPZ deal," the court stated. The court also concluded that the Williams' defendants had no duty to update their statements when, several days after the presentation, ETE made a formal merger offer, as the statements made to the analysts were "consistent with the possibility" that future developments could result in termination of the WPZ merger. According to the court, the plaintiff did not establish that the early discussions with ETE constituted "material" information, nor that the defendants had acted recklessly or with a fraudulent intent in not disclosing the information. The court wrote: "The complaint suggests no reason (other than a desire not to waste everybody's time) why Williams would not wish to disclose at the analysts presentation that ETE had made overtures to Williams about a merger…."

ADVANCE NOTICE BYLAWS

A Washington Court Affirmed a Board's Right to Reject Shareholder Nominations that Did Not Comply With the Company's Advance Notice Bylaw Information Requirements—*Blue Lion Opportunity Master Fund, L.P. v. HomeStreet, Inc.* (Apr. 3, 2018). The Superior Court of Washington for King County rejected a request by Blue Lion for an injunction against HomeStreet's rejection of Blue Lion's notice of director nominations. Blue Lion contended that the notice substantially complied with all requirements and that HomeStreet's rejection of the notice was on purely technical grounds. Blue Lion noted that the notice was delivered by the advance notice deadline and was over 100 pages long. However, HomeStreet, a Washington corporation, contended that advance notice bylaws should be strictly enforced. The required information that was not included in the notice consisted of the ownership of HomeStreet shares by Blue Lion's affiliates, a representation as to how Blue Lion intended to vote its shares at the meeting, and information required by reference to the requirements of the federal proxy rules (such as the shareholder's estimated proxy contest costs and whether it planned to seek reimbursement of those costs from the company). Both parties urged the court to rely on Delaware case law, given the lack of Washington precedent on point.

The court confirmed that it was within the purview of the HomeStreet board's business judgment to adopt its advance notice bylaw and to reject Blue Lion's notice for failure to comply with the bylaw's requirements. Notably, HomeStreet had adopted the bylaw "on a clear day" many years earlier in connection with the company's initial public offering (and not in response to a threat or perceived threat from Blue Lion or any other stockholder). HomeStreet also argued that the circumstances were not such that it was impossible for Blue Lion to comply with the bylaw's requirements and that there had not been a material change since the advance notice deadline. The court rejected Blue Lion's argument that enhanced scrutiny applied to the board's decision to reject its notice, reasoning that rejection of a non-compliant notice did not constitute the taking of a defensive action. The court also rejected Blue Lion's argument that Blue Lion would be irreparably harmed in the absence of injunctive relief, observing that Blue Lion had the alternative of seeking a special meeting of shareholders to achieve its objective.

After the decision was issued, Washington State regulators determined that Blue Lion's accumulation of proxies constituted its seeking to exercise a controlling influence over HomeStreet (a bank) and that Blue Lion had failed to obtain state regulatory approvals required to launch such a proxy contest. HomeStreet's three board nominees were elected at the annual meeting in May 2018. The case serves as a reminder that advance notice bylaws can provide meaningful protection to a company and, depending on the circumstances, may be enforced relatively strictly.

CONFIDENTIAL INFORMATION

The Court of Chancery Granted a Motion to Dismiss Claims that a PE Firm Owning Interests in Two Competitors Misused Confidential Information—*Alarm.com Holdings v. ABS Capital Partners* (June 15, 2018). The court found that the alleged facts did not support a reasonable inference that a private equity firm had improperly used confidential information of one of its portfolio companies ("Alarm.com") after the firm acquired a significant interest in (and the right to appoint a director to the board of) a company that directly competed with Alarm.com. The complaint alleged that the PE firm obtained Alarm.com's confidential information, including trade secrets, through one of the firm's partners on the Alarm.com board and that the PE firm then "misused the corporation's confidential information by investing in the competitor." The court noted that several agreements between the PE firm and Alarm.com (including a nondisclosure agreement entered into in connection with the PE firm's due diligence prior to acquiring its interest in Alarm.com and two stockholder agreements) "memorialized that the private equity firm could and would invest in competing businesses." In addition, importantly, the Alarm.com charter included a provision authorized by DGCL Section 122(17), which exempted stockholders such as the PE firm from any duty not to pursue corporate opportunities that otherwise might arguably belong to Alarm.com. (Section 122(17) provides that a corporation has the power to "[r]enounce, in its certificate of incorporation or by action of its board of directors, any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, …specified classes or categories of business opportunities….")

The court held that, in light of the Section 122(17)-authorized charter provisions disclaiming any restriction on business opportunities, the several agreements dating over many years that reflected a "shared understanding" of the parties that there would be no such restrictions, and the absence of specific allegations beyond the mere fact that the PE firm had made the investment in Alarm.com's competitor, "the facts alleged…do not support a reasonably conceivable inference of misappropriation." The court noted that the partner serving on the competitor's board had never served on Alarm.com's board nor even attended any of its meetings.

The case highlights the potential for claims of misuse of confidential information in connection with a PE firm's ownership of and board representation at portfolio companies with overlapping businesses. It serves as a reminder that PE firm-appointed directors have fiduciary duties to all of the portfolio company's stockholders (not just the PE firm) and that appropriate corporate governance measures and specific agreements should be in place with respect to confidential information, corporate opportunities, investing in competitors, and other potential conflicts of interest.

APPRAISAL

Below-the-Deal-Price Appraisal Results Were Reaffirmed by the Delaware Supreme Court and the Court of Chancery —*ACP v. Sprint* affirmance (Apr. 23, 2018) ***and Verition v. Aruba* reargument motion** (May 21, 2018). In the appeal of *ACP v. Sprint*, the Delaware Supreme Court, without comment, upheld the Court of Chancery decision relating to the 2013 buyout of Clearwire by its majority stockholder, Sprint. The Court of Chancery had (i) held that the merger satisfied the "entire fairness" test even though the sale process was substantially "flawed" and (ii) determined that the appraised "fair value" of a Clearwire share was 60% *below* the price paid in the merger. The Court of Chancery found that entire fairness was established based on the merger price having provided stockholders with "substantially more in value than what they had before [the merger]" (which conclusion, the court suggested, overcame the flaws in the sale process). In determining appraised fair value, the Court of Chancery relied on a discounted cash flow analysis (and not the merger price) because the merger was a *non*-arm's-length transaction effected by the company's controller. The Court of Chancery attributed the below-the-deal-price result to the significant synergies that were expected in the deal (some of the value of which was included in the merger price but none of which is taken into account in a DCF analysis).

After the Court of Chancery issued its *Sprint* decision, the Delaware Supreme Court issued its landmark *Dell* appraisal decision in which the Supreme Court held that, in the case of an arm's-length merger with a "robust" sale process, the deal price is generally the best "proxy" for, and should be given "heavy, if not determinative weight" in determining, appraised fair value. Since *Dell*, the Court of Chancery has issued two below-the-deal-price decisions (both in Feb. 2018). In one, *Aruba*, the court relied solely on the 30-day unaffected market price of the target shares. In the other, *AOL*, the court relied on the merger price but deducted from it the value of expected synergies—based on the (previously rarely applied) statutory mandate to exclude from fair value any value that is expected to arise from the merger itself.

On May 21, 2018, in *Aruba*, the Court of Chancery declined to grant the petitioners' request for reargument and defended its reliance on the unaffected market price. The petitioners argued that the court had "misapprehended the law," but the Court of Chancery defended the reliability of the unaffected market price in cases involving "semi-strong efficient markets," citing the Supreme Court's emphasis in *Dell* on reliance on market-based factors in cases involving third party arm's-length mergers.

These cases highlight that there is now a meaningful possibility of appraisal results being below the deal price in cases involving arm's-length mergers and it is likely that the court may reach significantly *above*-the-deal-price results only in arm's-length merger cases involving a seriously flawed sale process and in *non*-arm's-length merger cases (such as controller transactions, squeeze-outs, and certain MBOs).

Additional Appraisal Developments. Two appraisal decisions (both notable) have been issued so far in the third quarter of 2018—*Blueblade Capital Opportunities v. Norcraft* (July 27, 2018) and *In re Appraisal of Solera Holdings* (July 30, 2018). In *Norcraft*, which involved an arm's-length merger, the Court of Chancery declined to rely on the deal price to determine appraised fair value because the sale process was "seriously flawed." Relying solely on a DCF analysis, the court found fair value to be about 2.5% *above* the deal price. In *Solera*, the Court of Chancery relied solely on the deal price (after finding that the sale process, although "not perfect," was not seriously flawed) and made a downward adjustment to deduct the value of expected synergies shared with the target company stockholders—with a result that was about 3.4% *below* the deal price. The court suggested that the deal-price-less-synergies approach would apply in all arm's-length merger cases where the sale process was not seriously flawed. *We will be issuing a Fried Frank M&A/PE Briefing on* Norcraft *and* Solera *shortly.*

In summary:

	Type of Transaction	Court Relied On	Reason for that Reliance	Result Was Above/ Below Deal Price
Sprint	Controller	DCF analysis	Not arm's-length transaction	Below (60%) (court attributed this to synergies not being taken into account in a DCF)
Aruba	Arm's-length	Unaffected market price	Viewed as the best "market-based" approach (notwithstanding *Dell* emphasis on reliance on deal price)	Below (31%)
AOL	Arm's-length	Deal price less synergies		Below (3%)
Norcraft	Arm's-length	DCF analysis	"Seriously flawed" sale process	Above (2.5%)
Solera	Arm's-length	Deal price less synergies		Below (3.4%)

In conclusion, the *Aruba*, *AOL* and *Solera* appraisal decisions highlight the new, meaningful possibility of appraisal results in cases involving arm's-length mergers being below the deal price—based on reliance by the Court of Chancery on (a) the deal price (less synergies expected in the merger—as mandated by the statute) (the approach championed by the Supreme Court in *DFC Global* and *Dell*), or (b) on the unaffected market price of the acquired company's stock (the approach championed by Vice Chancellor Glasscock in *DFC Global* on remand, and apparently confirmed as valid (although not applied) in *Norcraft* and *Solera*). *Sprint* underscores the unpredictability of the DCF methodology and, thus, the possibility of a well-below-the-deal-price result even in the context of a *non*-arm's-length transaction. At the same time, *Norcraft* reflects that the court may reach above-the-deal-price results in arm's-length merger cases where it deems the sale process to have been seriously flawed. We note that above-the-deal-price results may also continue to be reached in *non*-arm's-length merger cases, such as controller transactions, squeeze-outs, and certain MBOs.

LLCs AND PARTNERSHIPS

In Several Decisions, the Court of Chancery Addressed the Duties of Directors and Managers of LLCs and Other Non-Corporate Entities—*Williams v. ETE* (May 17, 2018), ***MHS Capital v. Goggin*** (May 10, 2018), ***Eames v. Quantlab*** (May 1, 2018), ***Capone v. LDH*** (Apr. 25, 2018), **and *Leaf Invenergy v. Invenergy Wind*** (Apr. 19, 2018). These decisions reaffirm that, in the LLC or partnership context, fiduciary duties are contractual in nature and thus are determined by the express terms of the governing agreement (subject only to the implied covenant of good faith, which cannot be waived but which is applied narrowly by the court)—that is, sophisticated parties can expressly waive common law fiduciary duties in LLC and partnership agreements. These decisions serve as a reminder of the importance both of careful drafting of such agreements with respect to fiduciary duties and of strict adherence by managers to the contractual terms to obtain safe harbor protections included in the agreements. For further discussion, see **here** our M&A/PE Briefing, *LLC Directors' and Managers' Obligations—Key Principles, Practice Points and Recent Delaware Decisions* (June 6, 2018).

- **In *ETE***, the Court of Chancery ruled that the limited partnership's conflicts committee safe harbor was not available as two of the three members initially designated as members of the committee were ineligible to serve under the terms of the limited partnership agreement. Only the one eligible member had actually ever served, the minutes were revised to reflect that there was only one member, and the board was fully aware and had no problem with the fact that there was only one member. However, the court emphasized that the committee had never been formally reconstituted to consist of only the one eligible member. The decision underscores that conflicts committee safe harbor approval can be lost if the process set forth in the agreement (including with respect to who is qualified to serve on the committee) is not followed precisely.

- **In *MHS***, the Court of Chancery, at the pleading stage, rejected dismissal of the plaintiff's breach of contract claim against the LLC manager who allegedly had diverted LLC interests and funds to enrich himself and his friends. The manager contended that the breach of contract claims should be dismissed on the basis that the exculpatory clause of the LLC agreement provided that he could not be liable for monetary damages (even in the event of a breach of the implied covenant of good faith). The court rejected the motion to dismiss, finding that it was unclear under the agreement how the provision setting forth the general standard of care required of the manager ("good faith and ordinary care") was "meant to work with the exculpatory clause, which purports to eliminate all damages." The decision highlights the importance of careful drafting of an LLC agreement to eliminate ambiguity in the interrelationship of the provisions within an agreement or among related agreements.

- **In *Eames***, the limited partnership agreement provided that the general partner (GP) could not be removed without the GP's consent; and the LLC agreement governing the GP provided that each of the GP's two managers could act alone to transact business "for the benefit" of the GP. The court held that the consent of just one of the members was not sufficient to agree to removal of the GP because the removal was *not* for the GP's benefit. The decision reflects the ambiguity that can arise with respect to the interrelationship of various provisions within and among agreements relating to a general partner's duties.

- **In *Capone***, the Court of Chancery, at the pleading stage, denied the defendants' motion to dismiss a claim that, under an LLC agreement that required valuation by the board, as of a specified date, of units called by the LLC upon termination of the unitholder's employment, the LLC board had an implicit duty to revalue the units after the board received new information indicating that the prior valuation significantly understated the value of the units. The court emphasized that the valuation provision included the caveat that the valuation was to be produced by the board as specified "unless otherwise determined by the board." According to the court, this clause suggested that, notwithstanding the general disclaimer of fiduciary duties and the specified valuation approach, the parties intended that the board would have discretion as to how to determine the valuation, which perhaps should have been exercised. The decision again reflects the need for clarity with respect to the interrelationship of the various provisions that relate to board duties.

- **In *Leaf Invenergy***, the LLC agreement provided that the company could not engage in a sale of assets without the consent of certain of its members unless those members would achieve at least a specified agreed rate of return (the "target multiple") in the proposed transaction. The Court of Chancery found, at the pleading stage, that the agreement had been breached by the LLC board when it sold assets without the consent of one of these members. The court also accepted, at the pleading stage, the plaintiff's allegation that the clear expectation of the LLC and that member had been that, if such a breach occurred, the company would pay the member an amount equal to the target multiple. However, after a trial to determine the proper remedy for the breach, the court awarded the member only nominal damages of $1 because (i) the LLC agreement itself did not contain a provision clearly stating what the damages would be and (ii) the member did not suffer harm from the breach (because the asset sale that had been effected without its consent was at an "attractive price" that increased the value of its LLC interest). The decision highlights the importance of expressly memorializing the parties' expectations in specific terms in the LLC agreement (in this case, with respect to a liquidated damages remedy for a breach).

NON-COMPETES

Injunctive Relief for Non-Compete Violations Was Denied Where Both Parties Violated Their Respective Non-Compete Obligations—*InTeam v. Heartland* (Mar. 29, 2018). In connection with an asset purchase agreement, both parties agreed to certain non-competition restrictions. In earlier proceedings, the Court of Chancery had determined that one party had violated its non-compete obligations and the other party had not. The Delaware Supreme Court reversed, holding that both parties had violated their respective non-compete obligations. On remand for the crafting of a remedy, the court rejected both parties' request that an injunction be issued against the other party's violation of its non-compete obligations. The Court of Chancery reasoned that equitable relief was precluded under the "unclean hands" doctrine. (Damages, consisting of the disgorgement of consulting fees earned by one of the parties during the period of breach, were awarded, as damages are not an equitable remedy so the unclean hands doctrine did not apply.) The case is a reminder that equitable remedies, such as injunctions and specific performance, may not be available in connection with the breach of non-compete, confidentiality or similar obligations unless the requesting party is itself in compliance with its own obligations under these provisions.

DEAL TERMS

A Recent Merger Agreement Included a "Ticking Fee." Novartis AG (a pharma company) successfully completed its $8.7 billion acquisition of AveXis Inc. in May 2018. The merger agreement between the parties was notable for having included an infrequently seen provision known as a "ticking fee." Novartis had the right, if it did not receive regulatory approval of the deal by July 6, 2018, to extend the "drop-dead date" (*i.e.*, the last date on which it could close the merger) to October 6, 2018. If Novartis had extended the drop-dead date, the $218 per share deal price would have automatically increased to $225 per share. If, after extending the drop-dead date, regulatory approval were not obtained, the "reverse termination fee" payable by Novartis would have increased in $100 million increments depending on the length of the extensions of the drop-dead date, to a fee of up to $722 million instead of the $437 million which would have been payable had the deal been terminated before July 6, 2018.

REGULATORY DEVELOPMENTS

Fund Advisers Charged for Failures to File Form PF or to Timely Deliver Audited Financial Statements to Investors. On June 1, 2018, the SEC announced settlements with thirteen registered investment advisers that failed to file Form PF over multi-year periods. In the settlement orders, the SEC highlighted the importance of the information collected on Form PF to financial regulators, including to the SEC's examination and investigation programs and its investor protection efforts relating to private fund advisers. Each registered investment adviser charged was ordered to pay a civil money penalty of $75,000. Please see **here** our Memorandum, *SEC Charges 13 Private Fund Advisers for Repeated Failures to File Form PF* (June 1, 2018). On July 17, 2018, the SEC announced a settlement with a registered investment adviser for failure to timely deliver audited financial statements to its fund investors. Please see **here** our Memorandum, *SEC Fines PE Adviser for Repeated Late Distribution of Audited Financials* (July 18, 2018).

Both Houses of Congress Finalized a Bill Expanding CFIUS's Capabilities (July 26, 2018). The Congressional Conference Committee has agreed to a final version of the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"). The bill would expand the definition of "covered transactions" to include non-control transactions involving critical infrastructure, critical technologies, and businesses that maintain personal data of U.S. citizens, as well as certain real estate purchases, leases, and concessions in close proximity to US government or military facilities. It would also extend the initial review period to 45 days (up from 30 days), and allow for a 15-day extension of the investigation period (currently 45 days) under extraordinary circumstances. The bill would require mandatory declarations (short-form filings) for certain foreign government-controlled transactions, and, to help fund CFIUS's operations, would institute fees that would be capped at the lesser of $300,000 or 1% of the proposed transaction value.

The EC Imposed a €124.5 Million Fine for Exercising Influence Under Pre-Closing Covenants Before Receiving Regulatory Approval for the Merger (Apr. 24, 2018). The European Commission fined Altice (a Netherlands-based company) for "effecting" its acquisition of PT Portugal before receiving regulatory approval. The fine was the highest the EC has ever issued. This was the first time that the EC took issue with the wording of the pre-closing covenants in a merger agreement. The EU concluded that Altice had acquired the legal right to exercise decisive influence over the target company through the grant in the transaction agreement of veto rights over *ordinary course* business matters (rather than only extraordinary matters). The EU also concluded that Altice actually had exercised decisive influence in certain instances, including by instructing the target company with respect to a marketing campaign and by seeking and receiving detailed, commercially sensitive information about the target company outside the framework of any confidentiality agreement. The Commission stated that the fine imposed "reflects the seriousness of the infringement…." Altice has announced that it will appeal. Please see **here** the Fried Frank Antitrust & Competition Law Alert, *Cautionary Tale for Mergers: Commission Imposes Record Gun-Jumping Fine* (April 30, 2018). In addition, in a separate matter, on May 31, 2018, the first ever EU-level guidance was issued on gun-jumping—in this case, in the context of termination of an operating agreement prior to obtaining clearance for the contemplated merger. Please see **here** our Memorandum, *Ernst & Young: first guidance on gun-jumping at EU level* (April 30, 2018).

The SEC Proposed Interpretive Guidance and Rules for Broker-Dealers and Investment Advisors (Apr. 18, 2018). The SEC voted 4-1 to issue the Standards of Conduct for Investment Professionals Rulemaking Package, which is roughly 1,000 pages long and comprises three releases, one of which is a proposed interpretation and two of which are proposed rules regarding the standards of conduct for investment advisers and broker-dealers. In one release, the SEC proposed an interpretation of the federal fiduciary duty applicable to investment advisers and requested comment on whether registered investment advisers should be subject to three additional requirements similar to those that currently apply to broker-dealers. In the second release, the SEC proposed a client relationship summary rule which would require both investment advisers and broker-dealers to provide information to retail investors prior to establishing a client relationship, and which is designed to help retail investors make a more informed choice when deciding whether to open a brokerage account or an investment advisory account. In the third release, the SEC proposed Regulation Best Interest, which would establish a new standard of conduct applicable to broker-dealers when recommending securities to their retail customers. In the Proposals, the SEC acknowledges that the nature of the client relationship and the models for providing advice differ between investment advisers and broker-dealers, and the Proposals do not contemplate a uniform standard of conduct or regulation applicable to investment advisers and broker-dealers, although they are designed to more closely harmonize the standards and regulations. For further information, see **here** our Memorandum, *SEC Issues Proposed Rules and Interpretive Guidance Addressing Standards of Conduct for Broker-Dealers and Investment Advisers.*

The SEC Issued a New C&DI Clarifying that Forecasts Provided to a Board and Bidders Do Not Require GAAP Reconciliation (Apr. 4, 2018). The SEC's Division of Corporation Finance posted two new compliance and disclosure interpretations (C&DIs) which, expanding on C&DIs issued in October 2017, confirm that forecasts provided to the board of directors or to bidders in connection with a business combination transaction will not be deemed to be "non-GAAP financial measures" that would require reconciliation with GAAP. Question 101.02 excludes forecasts provided to the registrant's board or a board committee from the definition of "non-GAAP financial measures." Question 101.03 extends that exclusion to forecasts exchanged between the parties to a business combination transaction when the forecasts are deemed to be material and must be disclosed to comply with the anti-fraud and other liability provisions of the federal securities laws.

The SEC Issued New Guidance on Public Company Disclosure on Cybersecurity Risks. Recently, the SEC unanimously approved new guidance on public companies' disclosure obligations regarding cybersecurity risks and incidents. The SEC's Statement and Guidance on Public Company Cybersecurity Disclosures (the "New Guidance") discusses the importance of cybersecurity-related disclosure in the context of current reporting obligations, presenting specific guidance on topics for inclusion in public disclosure. In addition, the New Guidance focuses on two aspects of cybersecurity not addressed in prior SEC staff guidance on the topic: (1) the vital importance of enacting and maintaining cybersecurity risk management policies and procedures, including disclosure controls, and (2) the relationship between cybersecurity risk and compliance with insider trading prohibitions. The New Guidance notes that while cybersecurity disclosure has increased since 2011 when the SEC last issued guidance on the topic, only 38% of US companies included cybersecurity risk factors in their SEC filings as of October 2017. For further discussion, see **here** our memorandum, *SEC Announces New Guidance for Public Company Disclosures on Cybersecurity Risks*.

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Fried Frank M&A/PE Briefings Issued 2Q 2018

(Please click on the title to see the Briefing)

- *LLC Directors' and Managers' Obligations—Key Principles, Practice Points and the Recent Delaware Decisions* (June 6, 2018)
- *Court of Chancery Rejects Extending Appraisal Rights Based on the "Underlying Economic Reality" of a Merger Structure—North Miami v. Dr Pepper Snapple* (June 5, 2018)
- *When a Minority Stockholder Has Truly "Outsized Influence," Its Self-Interested Transaction May Be Subject to Entire Fairness Notwithstanding a Special Committee Process-- And Other Points from Controller Decisions Issued in 1Q 2018--Rouse, Tesla, Oracle, NEA* (Apr. 11, 2018)

Fried Frank M&A/PE *Round-Up*

Fried Frank's M&A practice advises clients on some of the largest and most complex US and global deals, providing counsel to a full spectrum of companies on sophisticated transactions that are often multi-jurisdictional and, in some cases, transformational. With over eighty attorneys in four offices, our team has deep experience advising public and private companies, special committees, audit committees, and boards of directors in complex negotiated and contested situations, including negotiated mergers, hostile takeovers and takeover defense, proxy contests, financial adviser representations, and restructuring transactions.

PRO BONO IMMIGRATION MATTERS

A recent Bloomberg Law article noted the Firm's pro bono representation on behalf of asylum-seeking immigrant families in partnership with the CARA Pro Bono Project in Dilley, Texas. The Firm was also a cosigner of a recent op-ed that ran in The New York Times condemning the government's actions related to the separation of children and families at the border; and the firm is currently representing 11 mothers being detained in Dilley recently reunified with their children who face immediate deportation (potentially without their children).

MATTER HIGHLIGHTS

Highlights of Our 2018 Second Quarter Work Include Representations of:

- Counsel to **Aleris Corporation** in its US$2.6 billion sale to Novelis Inc.
- Counsel to **Permira Funds** in its acquisition of Cisco's Service Provider Video Software Solutions (SPVSS) business for an undisclosed sum; in its US$350 million majority investment in WeddingWire; and in its US$1.68 billion sale of Magento Commerce to Adobe.
- Counsel to **Humana, Inc.** (NYSE: HUM) as part of a consortium with TPG Capital and Welsh, Carson, Anderson & Stowe in its acquisition Curo Health Services for approximately US$1.4 billion, in which Humana acquired a 40% minority interest.
- Counsel to **Becton, Dickinson and Company** (NYSE:BDX) in its acquisition of TVA Medical.
- Counsel to **BakerCorp International Holdings, Inc.** in the US$715 million cash sale to United Rentals, Inc. (NYSE:URI).
- Counsel to **CVC Capital Partners** in its sale of Wireless Logic to Montagu Private Equity.
- Counsel to **Goldman Sachs Asset Management's Petershill** program in its acquisition, along with Blackstone's Strategic Capital Group, of a minority stake in Francisco Partners.
- Counsel to **ThreeSixty Group**, a portfolio company of AEA Investors, in its acquisition of Vornado Air.
- Counsel to **Goldman Sachs Merchant Banking Division** in its investment in the acquisition through its fund West Street Capital Partners VII, together with Hearst, of Slickdeals.
- Counsel to **Dyal Capital**, a division of Neuberger Berman, in its strategic minority investment in Round Hill Capital.

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