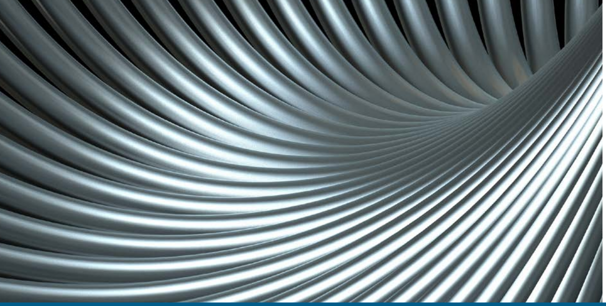

Sidley Perspectives

ON M&A AND CORPORATE GOVERNANCE

OCTOBER 2015

IN THIS ISSUE

ANALYSIS

PROJECTIONS IN PUBLIC COMPANY M&A

by Thomas A. Cole, Partner[1]

Target company projections play a pivotal role in any deal—in price negotiations and in determination of financial fairness. They are also likely to be publicly disclosed. To state the obvious, those projections need to be viewed with a critical eye by both target and bidder from the very outset of the process.

Target Board Diligence on Its Management's Projections

Before a target's projections are delivered to a bidder or even the target's own financial advisor, the target board should ask the following questions—the answers to which may lead to appropriate revisions to the projections:

- Do these projections reflect our best current thinking? If the projections were prepared in the ordinary course (typically right around year end in most companies' planning cycles), but the board is considering a transaction in the third quarter of the year, those projections may be quite stale. If the company's actual performance during the year has been materially different from what had been projected or if there have been material unanticipated developments in the business or macro-economy since the date those projections were reviewed by the board, it may be appropriate for management to refresh the projections and re-present them to the board.
- How do these projections compare to any others we have supplied to third parties in the recent past, and what is the justification for any differences? For example, issuers will on occasion supply lenders with projections when negotiating loan agreements and will make those projections more conservative than the ones they use to run the business.
- How good is management at preparing projections? Do we typically exceed or miss our projections? Especially if there is a consistent answer to that second question, the board should consider asking for supplemental projections in addition to the base case—whether labeled upside/downside or a plus-and-minus sensitivity case. If multiple sets of projections are created, however, then depending upon the circumstances they may all be required to be disclosed in the proxy statement.
- Do the projections include the impact of new business opportunities that have been discussed in strategy sessions of the board? If not, have some of those opportunities matured to the point (e.g., we have begun funding related capital expenditures) that their impact should be quantified and included in the projections? Alternatively, should we do a separate analysis of the potential future value of those opportunities and consider that value on a probability or risk adjusted basis as we consider the adequacy of a bid?

1 Thomas A. Cole is a partner in Sidley's Chicago office who served as chair of the firm's Executive Committee for 15 years. The views expressed in this article are those of the author and do not necessarily reflect the views of the firm.

If the foregoing questions lead to revisions in the projections from the set that was previously prepared in the ordinary course, the board should be provided a bridge between the two sets of projections. That bridge may also be useful when a bidder asks whether the projections it is being provided were prepared in the ordinary course. (See below.)

On occasion, a board member will be heard to say something like "let's be sure to put our best foot forward when we prepare our new projections." If that is a polite way of saying "let's jack up the numbers before we give them to the bidder…everybody does it," there are three responses. First, when the bidder is told that the projections it is receiving were not prepared in the ordinary course, its next question should be "will management's incentive compensation be judged on the basis of this new set?" The obvious best answer to that question will be "yes," so management itself will not want to get carried away with unwarranted upward adjustments. Second, as discussed below, the projections will likely be disclosed in a merger proxy statement or Schedule 14D-9. If the deal does not close, the company will have to live with those projections. Third, taken to an extreme, "jacked-up" projections can be fraudulent.

Projections can be fraudulent if they were not made in good faith or they lack a reasonable foundation.

As noted in V.C. Laster's opinion in *Fox v. CDX Holdings* (Del. Ch. Jul. 28, 2015)—

> During a sales process, a company may provide optimistic or bullish projections to bidders, even "extremely optimistic valuation scenarios for potential buyers in order to induce favorable bids." There is an important line, however, between responsibly aggressive projections and outright falsehoods: "Pushing an optimistic scenario on a potential buyer is to be expected; shoveling pure blarney at that stage is another." *Pennaco Energy*, 787 A.2d at 713. "An optimistic prediction regarding a company's future prospects" may rise to the level of a "falsehood" if accompanied by "evidence that it was not made in good faith (i.e., not genuinely believed to be true) or that there was no reasonable foundation for the prediction."

In a management buy-out, the concern is not with overly optimistic projections, but rather with "low ball" projections supplied by management to a special committee to facilitate the negotiation of a suppressed purchase price. This is what V.C. Laster found to have occurred in *In Re Dole Food Co. Inc. Stockholder Litigation* (Del. Ch. Aug. 28, 2015)—

> The projections Carter [the CEO's "right-hand man"] provided were knowingly false. Carter intentionally tried to mislead the Committee for Murdock's [the CEO's] benefit.
>
> The contrast between what Carter told the Committee and what he told Murdock's lenders and advisors during the Lender Meeting the next day confirms the fraudulent nature of the July Projections. So does the contrast between what Carter told the Committee and the instructions he gave a month later for the preparation of the budgets and projections that would be used to run the Company post-Merger.

Target Board Diligence on Its Financial Advisors' Extension of the Management Projections

When the target board is satisfied with the projections and they are turned over to the financial advisors for valuation analysis, it is often the case that a five-year projection is extended to ten years. The target board should carefully review that exercise, because the out-years can significantly impact the discounted cash flow valuation. In that review, some additional questions might be asked:

- For the out-years, what is the basis for, and how realistic are, the growth rates for revenues…the margin assumptions…etc.?
- If we are in a cyclical industry, have we built into the projections appropriate business cycles over the ten-year period?

Bidder Due Diligence on Target Projections

Upon receiving target projections, even before diving into detailed diligence, the bidder should ask the target the following questions:

- Were these projections prepared in the ordinary course? If not, why not?
- Will these projections be used in determining management's incentive compensation?
- May we see the projections that were reviewed by the target board over each of the past two or three planning cycles, so that we can assess management's acumen in forecasting?

A bidder should also compare target management projections with the Street's projections for the target. A significant disparity might be cause for inquiry, but it will also help the bidder anticipate how the Street (and the target board) will react to a proposed offered premium. That is, if the Street is considerably higher than target management on critical metrics, target investors may be disappointed in the premium, but the target board may be eager to accept it. Premium, of course, is legally irrelevant to assessing financial fairness, but is never far from the minds of investors and the pens of headline writers for the financial press.

Target and Bidder Assessment of Projected Synergies

Both boards should assess projected synergies with a critical eye. Synergies come in two categories: cost (sometimes labeled "hard") and revenue (sometimes labeled "soft").

For the target board, understanding the synergy potential for strategic bidders can help it decide whether or not to reach out to financial sponsors as potential competing bidders. Understanding synergy potential can also be a factor in the "ability to pay" assessment that is part of deciding on tactics in price negotiations. Significant anticipated synergies may be a basis for seeking a purchase price increase. Finally, in a stock deal, understanding projected synergies is relevant to assessing the value of the stock of the combined company.

For the bidder board, synergies can influence what it will be willing to pay. Synergies will also factor into how the winning bidder will communicate the deal to the Street. A couple of caveats in that regard are warranted. First, if revenue synergies are linked in any way to pricing power (as opposed to enhanced marketing through distribution channels), there could be implications for clearing antitrust regulatory requirements. Second, in an industry with price regulation (e.g., utilities), the regulators will seek to capture a portion of the synergies for the rate-payers.

Disclosure of Projections

Projections of material financial data developed by the target's management may have to be disclosed to the target's shareholders.

Careful attention should be given to the issue of whether projections of revenue, net income, EBITDA, cash flow or other material financial data developed by the target's management will need to be disclosed in the target's proxy statement, Schedule 14D-9 or other applicable disclosure document relating to the transaction. The SEC's position has generally been that where projections are provided by the target to the acquirer, those projections may constitute material information that should be disclosed to the target's shareholders. Delaware courts have generally held *(Plato Learning)* or stated in dicta *(Walter)* that financial projections prepared by management and shared with the target's financial advisor must, as a matter of Delaware fiduciary law, be disclosed to the shareholders. Although the cases focused on disclosures of free cash flow, the underlying rationale for the court's holding or dicta may apply to projections of other significant financial data.

IN APPROVING DISCLOSURE-ONLY SETTLEMENT, DELAWARE CHANCERY COURT TELLS MERGER LITIGANTS TO RESET EXPECTATIONS

By John K. Hughes, Partner[2]

Backdrop

According to Cornerstone Research, approximately 93% of deals valued over $100 million were challenged in shareholder litigation in 2014, with 59% of those cases being resolved before closing. Nearly 80% of such resolved litigation involved disclosure-based settlements. Only 8% of the settled lawsuits provided monetary return for shareholders.

There has been a tsunami-like surge in M&A litigation, where just about every type of public company transaction since the mid-2000s has been challenged. Most of this litigation settles before the applicable deal closes. The settlements typically involve defendants providing additional disclosures supplementing the merger proxy statement, while plaintiffs provide defendants with broad releases from further claims. Selling shareholders receive no additional consideration; defendants agree to plaintiff counsel's fee application.

The Delaware Chancery Court has expressed increased wariness over (1) substantial fee awards for disclosures of questionable value that do not change the overall mix of information for shareholders and (2) broad releases afforded defendants supported by questionable consideration. In the past, that Court has reduced plaintiff counsel fee requests after assessing the benefits afforded shareholders by the added disclosure. It has not often rejected settlement outright, but it has done so on occasion, including in *Acevedo v. Aeroflex Holding Corp.* (Del. Ch. Jul. 8, 2015) as discussed in our August 2015 issue of *Sidley Perspectives on M&A and Corporate Governance*. In *Acevedo*, the Court noted that, while disclosure-only settlements "have long [been] approved on a relatively routine basis," the value of the settlement consideration was insufficient to support the "intergalactic" or "broad class-wide release that extinguishes all claims against" defendants.

Court Approves Settlement, But Calls for Expectation Reset

In September 2015, the Delaware Chancery Court approved a disclosure-only settlement but signaled that it has adopted a stricter approach to approving such settlements. In *Re Riverbed Tech., Inc.* (Del. Ch. Sep. 17, 2015). The Court questioned the value of disclosures added to the proxy statement in response to plaintiffs' efforts, given that 99.48% of Riverbed's shareholders voted in favor of the merger after receiving the new disclosures. The Court also observed that there did not appear to be viable fiduciary duty or federal securities claims to pursue, so the Court viewed the give from the class for the releases afforded defendants was "basically nil."

Courts in jurisdictions outside of Delaware (e.g., New York, Maryland, Texas) also have shown increasing skepticism over disclosure-only settlements.

In approving the settlement, Vice Chancellor Glasscock pointed to the Delaware Chancery Court's past practice of approving similar settlements, and he noted that the parties' expectation of settlement approval in this case "bears some equitable weight here, [but it] will be diminished or eliminated going forward in light of this [opinion] and other recent decisions of this Court." Thus, deal litigants are now on notice that they should not expect disclosure-only settlements to be rubber-stamped by the Court in the future.

The Value of Supplemental Disclosures

After *Riverbed*, drafters of merger proxy statements should continue to anticipate that plaintiffs' counsel will scrutinize the Background of the Merger, Opinion of the Financial Advisor, and Projections sections of the merger proxy statement looking to find spaces within which to maneuver as part of the claim development process. Assessments as to the materiality of any additional disclosure, whether in response to any complaint filed or in settlement, will be measured against real-world situational dynamics involving the expediency of resolving the litigation prior to the shareholder vote and closing. But *Riverbed* and other recent rulings should give targets a firmer hand in negotiating supplemental disclosure demands.

---

2 John K. Hughes is a partner in Sidley's Washington, D.C. office focusing on M&A, Private Equity, and Corporate Governance matters. He was recently appointed to serve as the Vice Chair of the ABA Business Law Section's M&A Committee. The views expressed in this article are those of the author and do not necessarily reflect the views of the firm.

Broad Releases

Riverbed and other recent rulings highlight the flip-side of the disclosure-only settlement equation, which is the Court's concern about overly broad releases unsupported by adequate consideration. The Court in *Riverbed* found it did not appear known claims were being abandoned (based on representations made by plaintiffs' counsel), but found the breadth of the release troubling since there was no way for the Court to believe on the record before it that it could properly evaluate, and dismiss as insubstantial, all potential federal and state claims.

One obvious approach would be to limit releases to disclosure-related claims. That also raises questions as to whether such a move should reduce the fee award request for the incremental value of the broader release. But defendants understandably might argue that if they are paying to resolve nuisance litigation, they want something to show for it. This part of the debate also begs the question of what the M&A litigation world looked like previously, before disclosure-only settlements with broad releases were ubiquitous, and whether significant federal and state claims were routinely being brought against defendants that have recently been cut off in a disclosure-only settlement world, or if there are examples where such a release has cut off claims from being brought later.

Looking Forward

The Delaware Chancery Court predicted that in light of the Riverbed *opinion and other recent decisions, litigants would realize that peppercorn settlements and intergalactic releases will no longer be rubber-stamped by the Court, particularly if the plaintiffs' potential claims appear to have merit.*

Riverbed, together with *Aeroflex* and other recent Delaware Chancery Court rulings and judges' statements, evidence an evolving judicial sentiment that the M&A litigation system is broken. At a minimum, post-*Riverbed*, plaintiffs and defendants should expect far closer scrutiny of supplemental disclosures and overly broad releases. In addition, post-*Riverbed*, plaintiff counsel may become more selective in deals challenged, or back off proposed settlement terms and supplemental disclosure demands. Alternatively, plaintiff counsel may dig deeper, try harder to obtain expedition and during preliminary discovery try to find more meaningful support for breach of fiduciary duty claims or disclosure claims, if they exist. These rulings may also give defendants and their counsel firmer ground in responding to plaintiff claims. But, of course, the pressure on the part of defendants to sidestep an injunction threat and the related cost and nuisance of litigation and resolve litigation pre-closing and move on will remain.

NEWS[3]

JUDICIAL DEVELOPMENTS

Dole Executives Found Personally Liable for $148 Million for Undermining Sales Process

Recently, the Delaware Chancery Court issued a post-trial opinion in *In re Dole Food Co. Inc. Stockholder Litigation* imposing $148 million in personal damages on two executives. In June 2013, Dole's controlling shareholder and CEO offered $12 per share to acquire the 60% of Dole's common stock that he did not already own. To avoid the entire fairness standard of judicial review generally applied in controller-led take privates, and to satisfy the doctrinal approach set out in *In re MFW Stockholders Litigation*, the controller conditioned his bid on approval by a committee of independent directors, and a majority of the minority. The controller also made clear publicly he was a buyer and not a seller if another bid surfaced. Dole's board formed a special committee to evaluate the bid, and the committee negotiated the price to $13.50 per share (or $1.6 billion), the high end of the valuation range found by the committee's financial advisor. The committee approved the transaction and recommended it to the board, which approved it. No bid emerged during the 30-day

3 The following Sidley attorneys contributed to the research and writing of the pieces in this section: Steven Bierman, Beth E. Flaming, John K. Hughes, Jack B. Jacobs, Alex J. Kaplan, Marc E. Raven and Andrew W. Stern. We appreciate their contributions.

go-shop period. Shareholders approved the deal narrowly (50.9%) and it closed in November 2013.

Plaintiffs alleged (1) the merger was not entirely fair (and the business judgment standard should not apply), (2) the controller and two co-defendant officers had breached the duty of loyalty, (3) the committee was not independent, (4) a financial advisor first representing Dole and then the controller aided and abetted the breaches, and (5) defendants were liable for $600 million.

Defendants argued the more deferential business judgment standard applied given the procedural protections included in the proposal. But the Court disagreed and found defendants had the burden of demonstrating the merger was entirely fair. The Court determined defendants failed to meet that burden, finding the controller, and particularly the President/COO/GC, through a series of public announcements (e.g., underestimating cost savings from an earlier transaction, undervaluing certain assets and cancelling a board-approved stock buyback plan on a pretext without notice to board), deliberately drove down Dole's stock price to enable the controller to buy the company more cheaply and had timed the transaction opportunistically.

The Court also found the President undermined the special committee process in a number of respects. Those included (1) rejecting the committee's request for a broad mandate, (2) objecting to its efforts to select its own chairperson, (3) objecting to the financial advisor the committee selected and refusing to allow the advisor access to diligence materials until its engagement letter was revised to his satisfaction, (4) insisting on controlling confidentiality agreements with potential bidders, (5) orchestrating meetings between management and the controller's advisors and with funding sources in contravention of the committee's process rules, (6) refusing to comply with committee instructions, and (7) secretly assisting the controller in preparing for a hostile tender offer in the event the committee failed to approve the controller's offer.

The Court found even more troubling that the President knowingly provided false financial projections to the committee that did not account for the full annual cost savings Dole could realize from an earlier transaction or for cash flows from previously planned investments; and that he provided more accurate financial information to the controller and his lending sources and advisors than to the committee, all of which actions were designed to further the controller's interests over those of the committee.

Vice Chancellor Laster: "But what the Committee could not overcome, what the stockholder vote could not cleanse, and what even an arguably fair price does not immunize, is fraud."

In sum, the Court found that the controller and the President engaged in fraud by obstructing the committee's efforts to manage the sales process and negotiate with the controller, which ensured the committee could not act as an effective bargaining agent for the minority shareholders and rendered it "useless" despite "heroic efforts" by the committee and its advisors.

The Court also noted that, although $13.50 per share fell within an acceptable range of fairness, that price would have fallen on the low end of (or below) the range of fair value if the committee had received accurate financial information and not been subjected to the President's fraud. The Court determined shareholders were entitled to a "fairer" price and concluded the controller's deal undervalued the company by $2.74 per share, and ordered the controller and the President to pay the difference (approximately $148 million) to the plaintiff class.

> *THE DELAWARE DOWNLOAD*

Thoughts on the Dole Food Co. *decision from Jack B. Jacobs, senior counsel in our Wilmington office who served on the Delaware Supreme Court from 2003 to 2014 and, prior to that, on the Delaware Chancery Court since 1985:*

Although Dole Food Co. *is not the first case invalidating a "going private" transaction on* *entire fairness grounds, it is the first time a Delaware court has imposed multimillion dollar liability personally on individuals, as distinguished from the controlling shareholder entity itself. It may also be the first instance where the basis for liability was an adjudicated breach of the fiduciary duty of loyalty which was found to rise to the level of actual fraud. The case is especially noteworthy because the Court found the merger price to be "fair," but not fair enough. Because the controller fiduciaries had fraudulently deprived the special negotiating committee and the minority shareholders of material information relating to the company's value that, if disclosed, would have enabled the committee to negotiate a higher price or reject the deal altogether, the Court held that the shareholders were not limited to the traditional remedy of "an arguably fair price," but rather were entitled to "a fairer price"— in this case an additional $2.74 per share. The newly-articulated concept of "fairer price"—not previously recognized as accepted fiduciary doctrine—will likely give rise to more litigation.*

Shareholder-Adopted Bylaw Authorizing Shareholders to Remove Officers Held Invalid under Delaware Law

Vice Chancellor Noble: "A primary way by which a corporate board manages a company is by exercising its independently informed judgment regarding who should conduct the company's daily business. How a board without the power to control who serves as CEO could effectively establish a long-term corporate strategy is difficult to conceive…The stockholders' right to remove officers for any (or no) reason would unduly constrain the board's ability to manage the Company."

The Delaware Chancery Court recently issued a decision that sheds light on the power of corporate shareholders to limit or control the power of the board through the bylaw amendment process. *Gorman v. Salamone* (Del. Ch. Jul. 31, 2015). Gorman, the controlling shareholder of Westech Capital Corp., purported to remove Salamone, Westech's CEO, in a two-step process. First, Gorman acted by written consent to amend Westech's bylaws to allow shareholders to remove and replace corporate officers. Gorman then proceeded by written consent to remove Salamone as CEO and to name himself to that role. Salamone challenged this development in a Chancery Court proceeding under DGCL §225, which empowers the Court to determine a corporation's directors and officers. Salamone argued that both the amended bylaw and the written consent replacing Salamone with himself were legally invalid. The critical issue in the case was whether the bylaw amendment authorizing the shareholders to remove corporate officers, with or without cause, and without any need for board approval, was valid under Delaware law. The Chancery Court held that it was not.

The Court grounded its analysis on a 2008 Delaware Supreme Court decision which held that the shareholders' power to adopt or amend the bylaws was limited by DGCL §141(a), which vests the power to manage the business and affairs of the corporation exclusively in the board. *CA, Inc. v. AFSCME Emps. Pension Plan* (Del. Jul. 17, 2008). In that case, the Supreme Court determined that a shareholder-adopted bylaw that dictates how the board should decide a particular matter or category is invalid, whereas a bylaw that only establishes procedures or processes by which the board arrives at its decision is permissible. Applying the *CA, Inc.* analysis to the amended bylaw adopted by Gorman, the Chancery Court held that it was invalid, because shareholder removal of an individual from corporate office constitutes a substantive business decision that, if validated, would allow shareholders directly to manage the corporation's business and affairs. Once the shareholders voted to remove an officer, with or without cause, the board would be required to "immediately implement" the removal—a directive that "could compel board action, potentially in conflict with its members' fiduciary duties."

> THE DELAWARE DOWNLOAD

Thoughts on the Gorman *decision from Jack B. Jacobs:*

The Gorman *decision is potentially quite significant to corporate and M&A practitioners, if only because of the increasing resort by institutional (and particularly activist) investors to utilize the bylaw amendment process to limit the powers of boards in ways that are congenial to activist agendas. If reversed on appeal or otherwise overruled by the*

Delaware Supreme Court, Gorman *would add a new weapon to the already-formidable arsenal of institutional shareholders—through the proxy machinery and otherwise—to influence the composition of public company boards. If validated, a* Gorman *bylaw would also give activists a green light to focus their fire on specifically targeted members of senior management, by soliciting proxy consents to remove "disfavored" corporate officers.*

Trinity Wall Street Asks Supreme Court to Weigh in on Battle with Wal-Mart Over Rule 14a-8's "Ordinary Business" Exclusion

In our August 2015 issue of *Sidley Perspectives on M&A and Corporate Governance*, we discussed the Third Circuit's decision permitting Wal-Mart Stores Inc. to exclude a shareholder proposal from Trinity Wall Street church from its proxy materials under Exchange Act Rule 14a-8(i)(7), because the decision to sell assault rifles relates to Wal-Mart's ordinary business operations. *Trinity Wall Street v. Wal-Mart Stores, Inc.* (3d Cir. Jul. 6, 2015). Trinity Wall Street's proposal asks Wal-Mart's board to develop and implement standards for management to use in deciding whether to sell a product that (1) "especially endangers public safety," (2) "has the substantial potential to impair the reputation of Wal-Mart," and/or (3) "would reasonably be considered by many offensive to the family and community values integral to the Company's promotion of its brand." Despite Wal-Mart's announcement on August 16, 2015 that it will stop selling certain assault rifles, Trinity Wall Street filed a petition for a writ of certiorari with the U.S. Supreme Court on September 11, 2015 asking the Court to review the Third Circuit's decision. Trinity Wall Street argues that the Third Circuit's decision is in direct conflict with SEC interpretive guidance regarding the "ordinary business" exclusion and severely curtails the important rights of shareholders to bring corporate social responsibility proposals.

D.C. Circuit Reaffirms Decision that Conflict Minerals Disclosure Requirement Violates First Amendment

Some uncertainty remains as to whether companies that file conflict minerals reports in 2016 must obtain an independent private sector audit in connection with those reports, as contemplated by Form SD. This issue bears monitoring between now and May 31, 2016, the filing deadline for conflict minerals reports covering the 2015 calendar year.

Sidley represented the National Association of Manufacturers, the U.S. Chamber of Commerce and Business Roundtable when they filed suit challenging the "conflict minerals" rule adopted by the SEC under Section 1502 of the Dodd-Frank Act. One aspect of the rule provides that, unless a company can conclude that it has no "reason to believe" the conflict minerals contained in its products "may have originated" in the Democratic Republic of the Congo ("DRC") or adjoining countries, or can confirm that the minerals did not "directly or indirectly finance or benefit armed groups," the company must state on its website and in public reports filed with the SEC that the products have not been found to be "DRC conflict free." In challenging the rule, the business groups raised a number of arguments under the Administrative Procedure Act, and also contended that the compelled statement that products had not been found to be "DRC conflict free" violated the First Amendment. *National Association of Manufacturers, et al. v. SEC* (D.C. Cir. Aug. 18, 2015). In 2014, a panel of the U.S. Court of Appeals for the District of Columbia Circuit denied the Administrative Procedure Act challenges, but agreed that the compelled statement violated the First Amendment, because it "requires an issuer to tell consumers that its products are ethically tainted" when the issuer may "disagree with that assessment of its moral responsibility," and because the government could have deployed less speech-restrictive means to achieve its end.

Following the 2014 decision, the SEC staff issued a statement indicating that it "expects companies to file any reports required," which must include the factual information required by the rule, including a "description of the due diligence that the company undertook." However, the SEC would not require companies to "describe [their] products as 'DRC conflict free'" or having "not been found to be 'DRC conflict free.'" The statement also indicated that, pending further action, a company will not be required to obtain an independent private sector audit unless it "voluntarily elects to describe a product as 'DRC conflict free' in its Conflict Minerals report."

Subsequently, the D.C. Circuit ruled en banc in *American Meat Institute v. U.S. Department of Agriculture* (D.C. Cir. 2014) that the relaxed standard of review set forth in a 1985 U.S. Supreme Court decision was not limited to cases in which the government had an interest in preventing consumer deception, overruling prior circuit precedent which had been cited in the 2014 conflict minerals decision. The conflict minerals panel granted rehearing to consider the impact of this en banc decision, and in August 2015 again held that the conflict minerals rule violates the First Amendment. On October 2, 2015, the SEC and Amnesty International each filed a petition for an en banc rehearing of the August 2015 panel decision.

Circuits Split Over Whether Dodd-Frank Anti-Retaliation Protections Apply to Internal Whistleblowers

The Circuit split means that the Supreme Court may decide whether an employee who blows the whistle internally is protected by the Dodd-Frank anti-retaliation provisions.

The U.S. Court of Appeals for the Fifth Circuit ruled in 2013 that an employee had to first report misconduct to the SEC in order to avail himself of the anti-retaliation provisions of the Dodd-Frank Act's whistleblower rules. *Asadi v. G.E. Energy (USA), L.L.C.* (5th Cir. 2013). On August 4, 2015, the SEC published interpretive guidance confirming that a person who reports misconduct internally and suffers employment retaliation will be entitled to the Dodd-Frank anti-retaliation protections to the same extent as a person who is retaliated against after notifying the SEC. The guidance is available here. In September 2015, a divided panel of the U.S. Court of Appeals for the Second Circuit held that an employee who was terminated after reporting misconduct internally could bring a claim under the Dodd-Frank anti-retaliation provisions even though he had not reported the misconduct to the SEC. *Berman v. Neo@Ogilvy LLC* (2nd Cir. Sep. 10, 2015). A majority of the Second Circuit panel found the Dodd-Frank Act ambiguous on the issue, and therefore deferred to the SEC's interpretive guidance. The ruling created a Circuit split, and the defendants filed a motion on September 30, 2015 indicating that they intend to file a petition for a writ of certiorari with the U.S. Supreme Court prior to the December 9, 2015 deadline.

REGULATORY DEVELOPMENTS

The DOJ's New Focus on Individual Accountability for Corporate Wrongdoing Has Widespread Implications

Deputy Attorney General Sally Yates released a memo on September 9, 2015, and gave a major policy address the following day, outlining several changes the U.S. Department of Justice (DOJ) will implement "to ensure that individual accountability lies at the heart of [its] corporate enforcement strategy." Although the memo largely reflects and expands upon existing practices regarding the investigation and prosecution of corporate wrongdoing, the DOJ's emphasis on identifying the individuals who drove corporate misconduct promises to alter how the DOJ executes corporate investigations. Though touted in the press as an attack on Wall Street executives, the new policy will impact companies in industries far beyond the financial services sector. The new DOJ policy may, among other things:

- Substantially complicate the ability of companies to maintain privilege over internal investigations;
- Complicate the ability of companies to maintain joint-defense relationships with targeted executives; and
- Force boards of directors more frequently to consider establishing "special committees" to oversee government investigations in which executives are targeted.

Sidley attorneys in various practice groups have analyzed the Yates memo and circulated updates on this significant development. The Sidley Update circulated by our White Collar: Government Litigation & Investigations practice group is available here. Other Sidley Updates discuss particular implications of the new DOJ policy for life sciences companies, on D&O insurance policies and with respect to environmental enforcement.

HSR Enforcement Action Highlights Risks under Investment-Purpose Exemption

The premerger notification requirements of the Hart-Scott Rodino Act (HSR) may be triggered when an acquiring entity or individual intends to acquire stock of an issuer and will, upon completing the acquisition, hold more than $76.3 million of the issuer's stock. In particular, HSR requires that, before making a stock acquisition that would result in holdings valued in excess of this threshold (adjusted annually), the acquirer make a premerger filing with the Federal Trade Commission and U.S. Department of Justice and, in some cases, notify the issuer before doing so.

The recent settlement may result in earlier notice to issuers with a market cap greater than approximately $1.5 billion that they are targets of activist hedge funds.

There is an exemption from HSR reporting if the acquisition of shares is "solely for the purpose of investment." Notably, this exemption is not available if the acquirer intends to seek a board seat. For an issuer with a market capitalization over $1.526 billion, an activist will cross the $76.3 million threshold before it acquires 5% of the issuer's stock, so HSR may require the first notice to the issuer of the activist's accumulation of its shares.

In August 2015, the FTC and DOJ took the position that an investment fund could not rely on the investment-purpose exemption where it had taken actions including (1) contacting third parties to gauge their interest in becoming the CEO or a board member of Yahoo! Inc. (Yahoo), (2) assembling an alternate slate of directors for Yahoo, (3) drafting correspondence to Yahoo announcing the fund manager's interest in being represented on Yahoo's board, (4) internally discussing the possible launch of a proxy battle, and (5) publicly stating that it was prepared to propose a slate of directors at Yahoo's next annual meeting. This is potentially significant because the FTC and DOJ made clear that considering taking or preparing to take certain actions was enough to preclude an investor from availing itself of the exemption, at least where its activities are made known to persons outside of its organization, even if the investor has not actually formed an intention to take such actions. As a result, activists may be prompted to file HSR notices earlier than they would have before this development. See our Sidley Update here for more information.

SEC Adopts CEO Pay Ratio Disclosure Rule Required by Dodd-Frank

On August 5, 2015, the SEC adopted a much-anticipated new rule to implement Section 953(b) of the Dodd-Frank Act, which requires a public company to disclose the "pay ratio" between its CEO's annual total compensation and the median annual total compensation of all other employees of the company. Our Sidley Update summarizing the new rule and its implications is available here. For a calendar-year company, this disclosure will first be required in early 2018. The pay ratio disclosures that will result from the new rule will further heighten scrutiny on corporate executive compensation practices. On September 30, 2015, the House Financial Services Committee approved a bill to rescind the requirement for pay ratio disclosure. A similar bill has been introduced in the Senate.

New IRS Guidance Could Affect Tax-Free Spinoffs, Including REIT Spinoffs

On September 14, 2015, the U.S. Treasury Department and the Internal Revenue Service (IRS) issued Notice 2015-59 announcing that the IRS is reviewing certain spinoffs where either the controlled corporation (Spinco) or the distributing corporation (Parent) (1) has significant investment assets, (2) has qualifying business assets with a relatively small value or (3) elects to be a real estate investment trust (REIT). Pending its review, the IRS will generally suspend issuing private letter rulings in connection with these types of tax-free spinoffs. This is an important announcement as these types of transactions often, but not always, require the receipt of a favorable private letter ruling. In addition, the Notice may affect the willingness of law firms to issue tax opinions in connection with such spinoffs. See our Sidley Update available here for more information about the new guidance.

NYSE Updates Listing Rules on Material News Policy and Trading Halts

Updated NYSE listing rules may affect the timing and process for disseminating earnings releases and other material news.

Effective September 28, 2015, NYSE-listed companies must notify the NYSE at least ten minutes before releasing material news between the hours of 7:00 A.M. ET (rather than 9:30 A.M. ET, as previously required) and 4:00 P.M. ET pursuant to amendments to Section 202.06 of the NYSE Listed Company Manual. During the pre-market hours of 7:00 A.M. to 9:30 A.M., the rule changes give a listed company the sole discretion to advise the NYSE as to whether a trading halt is appropriate before disseminating material news. New advisory text to the listing rule requests that a NYSE-listed company planning to release material information after the market closes (typically 4:00 P.M. ET) wait to do so until the earlier of (1) publication of its security's official closing price on the NYSE or (2) fifteen minutes after the NYSE's scheduled closing time, in order to facilitate an orderly closing process.

The rule changes endorse two ways in which a NYSE-listed company may release material news to ensure adequate dissemination: (1) by including the information in a Form 8-K or other SEC filing or (2) by issuing a press release containing the news to at least one of the following major news wire services: Dow Jones, Reuters or Bloomberg.

Previously the NYSE only had authority to halt trading when a listed company intends to release material news during market hours. The rule changes now authorize the NYSE to temporarily halt trading in a listed company's security if it believes it is necessary to request and evaluate information from the listed company relating to: (1) material news, (2) the listed company's compliance with the NYSE's continued listing requirements or (3) any other information which is necessary to protect investors and the public interest. The NYSE memo summarizing the rule changes is available here.

CORPORATE GOVERNANCE DEVELOPMENTS

Proxy Access Continues to Gain Momentum

The campaign by shareholder rights proponents for proxy access—the ability for shareholders to include their director nominees in the company's proxy statement—has gained momentum in the 2015 proxy season. This is evidenced by an increase in (1) the number of shareholder proxy access proposals going to vote (88), (2) the average vote in favor of these proposals (54%) and (3) the rate at which these proposals have achieved majority support (59%). The number of companies that have adopted proxy access is also increasing, and companies are adopting it on fairly common terms with respect to the primary issues, although there continues to be some variation on details.

According to ISS data, more than 8% of companies in the S&P 500 have now adopted or committed to adopt proxy access.

41 companies have adopted proxy access so far in 2015, including several large companies such as Chevron, Coca-Cola, General Electric and Microsoft. Each of the proxy access provisions adopted during 2015 requires a nominating shareholder or group to beneficially own 3% or 5% of the company's outstanding stock for three years, and limits the maximum percentage of board seats for proxy access candidates to 20% or 25%.

In the fourth quarter of 2015, we expect to see an increase in the number of companies that adopt proxy access, as well as the number of shareholder proxy access proposals submitted for the 2016 proxy season. Our Sidley Update available here provides a comprehensive review of the latest developments on proxy access, including charts highlighting, on a company-by-company basis, the key terms of proxy access provisions adopted so far in 2015.

OECD Issues Revised Corporate Governance Principles

The Organisation for Economic Co-Operation and Development (OECD) issued the G20/OECD Principles of Corporate Governance on September 5, 2015 updating the corporate governance principles the OECD first developed in 1999 and last updated in 2004. The principles are an international benchmark providing best practice recommendations to governments on issues such as shareholder rights, the behavior of institutional investors and functioning of stock markets, financial disclosure and executive compensation. They have been incorporated by the Financial Stability Board (FSB) as one of the twelve key standards for international financial stability and serve as the framework for numerous national corporate governance codes. The updated principles reflect the increased globalization of stock markets and improvements made to corporate governance rules and practices in the past decade.

SIDLEY EVENTS AND SPEAKERS

Tom Cole, a partner in our Chicago office, will participate in a panel entitled *Strategies and Best Practices for Shareholder Engagement* at the Northwestern Law Corporate Counsel Institute in Chicago on October 8. Click here for more information.

The Annual Meeting of the Association of Corporate Counsel (ACC) will take place in Boston from October 18–21. Chris Abbinante and Brian Fahrney, partners in our Chicago office, will participate in a panel entitled *Challenging Issues in M&A Transactions* on October 19. The presenters will discuss a wide range of issues relevant to in-house counsel including: dealing with a seller-friendly deal environment; the role of in-house counsel in M&A; opportunities and pitfalls with earn-outs and other purchase price adjustment provisions; current due diligence hot button issues (including FCPA, OFAC and cybersecurity); shareholder activism; and lessons learned from recent M&A litigation. Click here for more information.

Suresh Advani, a partner in our Chicago office, will participate in a panel entitled *Interesting Transactions of the Past Year* as part of PLI's Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2015 scheduled for October 22 in New York and November 10 in Chicago. The program will include a review and critique of recent novel M&A transactions from a tax perspective. Click here for more information.

PLI's 47th Annual Securities Regulation Institute will take place in New York from October 28–30. Tom Cole, a partner in our Chicago office, will moderate a panel entitled *What to Do in a Crisis: Cybersecurity, Investigations, Whistleblowers, What Else?* on October 28. Tom Kim, a partner in our Washington, D.C. office, will participate in a panel entitled *Disclosure Quandaries: Conflict Minerals, Clawbacks and More* on October 30. Click here for more information.

Sidley will host its annual **Corporate College** in Chicago and New York from November 3–5. Sidley's Corporate College is a program intended to expose participants to a broad spectrum of topics likely to be encountered by a transactional lawyer. Sidley clients interested in attending should contact Puja Batura at pbatura@sidley.com or (312) 456-5789.

Jennifer Fitchen, a partner in our Palo Alto office, will serve on the faculty and as a panelist for several sessions of the ABA's 20th Annual National Institute on Negotiating Business Acquisitions to be held in South Beach, Florida on November 12–13. The program will cover, among other things, techniques used in structuring and negotiating M&A deals, the tax and securities law aspects of business acquisitions and the impact of legal and regulatory developments on M&A transactions. Sidley clients interested in attending should contact Jennifer Fitchen at jfitchen@sidley.com or (650) 565-7122.

On November 18–19, the Society of Corporate Secretaries & Governance Professionals and the ABA's Business Law Section's Corporate Governance Committee, chaired by Holly Gregory, a partner in our New York office, are co-sponsoring the third annual Delaware Law Issues Update conference in Wilmington, Delaware. Holly Gregory will moderate a panel entitled *Hot Issues in Corporate Governance & Preparing for the 2016 Proxy Season* on November 18. Jack Jacobs, senior counsel in our Wilmington office, will participate in a panel entitled *Legal Ethics Issues in Corporate Governance* on November 19. Click here for more information.

SIDLEY RESOURCES

Sidley recently published an Antitrust/Competition Update entitled *Back From The Future: FTC Stumbles in Challenging Merger's Effect on Future Competition*. The Update discusses the FTC's ongoing challenge of the proposed merger between Steris Corporation and Synergy Health plc on the basis that the transaction would impair potential future competition between the merging parties. In September 2015, a federal court denied the FTC's motion to preliminarily enjoin the merger pending the FTC's administrative hearing but also accepted as a legal matter the FTC's proffered "actual potential competition" theory of harm. This development serves as a reminder that courts and the antitrust agencies may not limit their competitive assessment of a merger to its effect on existing competition and may instead evaluate the merger's effect on potential future competition as well.

An article entitled *Mitigating the Risks of Stockholder Litigation in M&A Transactions* by James W. Ducayet, a partner in our Chicago office, was published recently in the *NYSE: Corporate Board Member Online*.

An article entitled *Advice for a First-Time Public Company CEO* by Tom Cole, a partner in our Chicago office, was published in the September/October 2015 edition of *NACD Directorship*.

An article entitled *Hot Topics for the 2016 Proxy Season* by Holly Gregory, a partner in our New York office, was published in the October 2015 edition of Practical Law's *The Governance Counselor*.

Sidley attorneys Holly Gregory, Rebecca Grapsas and Claire Holland authored the United States chapter of *Getting the Deal Through—Corporate Governance 2015*, an annual summary of key corporate governance practices in 32 jurisdictions worldwide. Topics addressed in the chapter include: sources of governance rules and practice, shareholder rights, duties and liability, anti-takeover devices, board structures, directors' legal duties, and disclosure and reporting requirements.

SIDLEY AUSTIN LLP
SIDLEY

sidley.com

AMERICA • ASIA PACIFIC • EUROPE