

2019

M&A REPORTER



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Dear Clients and Friends,

We are pleased to present the *Hunton Andrews Kurth 2019 M&A Reporter*. The past year was an exciting time for our firm. In April, we announced the merger of Hunton & Williams and Andrews Kurth Kenyon. From our beginnings in 1901 and 1902, respectively, both firms enjoyed long and proud histories. We carry remarkably similar culture and values, at the core of which is our desire to broaden the best-in-class resources we bring to bear on behalf of our clients, including a significant and diversified corporate and M&A practice.

Our combined firm advised clients on a broad range of transactions in 2018, including strategic corporate venture capital investments, private equity acquisitions and dispositions and a \$5.2 billion hostile takeover in the hotel REIT sector. We rank among the top 15 law firms worldwide in deals announced in the Thomson Reuters full-year 2018 league tables, **including ranking #7 for US Target Announced Deals**. This level of transaction volume gives our lawyers significant insight into market practices and deal terms.

Our firm continues our strategic focus on the depth of industry experience we have attained in four key sectors—**energy, financial services, real estate investment and finance, and retail and consumer products**. In the pages that follow, we hope you enjoy our insight into market trends and forecasting in these and other noteworthy areas of interest.

Our strong M&A performance is a testament to the firm's innovative and loyal clients, who continue to trust us to advise them in a wide range of challenging and interesting transactions. Hunton Andrews Kurth prides itself on client service and strategic relationships. We are grateful for your continued confidence in the work we do together.



A handwritten signature in black ink, appearing to read 'Wally Martinez'.

Wally Martinez
Managing Partner

Table of Contents

2019 M&A Forecast	4
Financial Services: 2018 M&A Year in Review for Bank Mergers	6
Energy: Oil & Gas...and Water!	8
Real Estate: Deal Focus - Pebblebrook Hotel Trust Acquisition of LaSalle Hotel Properties	10
Retail and Consumer Products: Retail M&A in 2018	10
Updates and Trends:	
Changes to M&A Resulting from CFIUS Adoption of Pilot Program	12
Antitrust Enforcement Still Unpredictable Under Trump	15
Trends for Distressed Transactions and Restructurings in 2019	16
Corporate and Securities Litigation Trends	18
Checking in on Tax Reform and Looking Ahead to 2019	19
A Material Adverse Effect Merger Termination in Delaware	20
The Culture of Counterparties	21
Select Design Considerations When Structuring Change-in-Control Pay	24
Preserving Insurance Assets Post-Merger	26
California Consumer Privacy Act and Its Impact on M&A Transactions	27
Deal Highlights	29
Key Contacts	35

Ranked #7 for 2018 US Target Announced Deals

– Thomson Reuters' M&A League Tables

2019 M&A Forecast

By John Clutterbuck, Brian Hager, Steven Haas, and Charles Brewer

2018 was another strong year for US M&A activity, with announced transaction volume totaling \$1.7 trillion across over 12,000 deals. It was a tale of two halves, however, as roughly \$1 trillion of that volume came in the first half of the year compared to just under \$700 billion in the second half. Although no single factor appears likely to drive M&A activity further downward, it remains to be seen whether the second-half slowdown will continue or whether M&A activity will rebound in the beginning of 2019.

US Equity Markets in 2018

US equity market returns broadly tracked M&A activity last year. The S&P 500 index was up 9% through September, but in a disappointing and volatile fourth quarter—including the worst December performance since 1931—it gave back all of those gains and more. This marked the first time that the index ended down for the year after rising over the first three quarters.

The S&P 500 index ultimately finished 2018 down 6%. This was the index's first down year since 2015, and its worst performance since 2008. Although equity markets briefly flirted with bear market territory in December, the current bull market—which recently reached the 10th anniversary of its March 2009 start—remained intact. The S&P 500 is up almost 300% since March 2009, but many analysts are now tempering their market performance forecasts for 2019 and 2020.

China Trade Concerns

One of the primary drivers of the stock market's poor fourth quarter performance appeared to be ongoing concerns regarding the trade relationship between the US and China. After exchanging rounds of escalating tariffs earlier in the year, the two countries agreed to a 90-day truce on December 1. Shortly before the expiration of the truce, President Trump said that, based on substantial progress in recent trade negotiations, he would delay any increase in tariffs set to take effect at the end of the truce period. President Trump did not announce the length of the delay, however, and it remains unclear when or whether a permanent agreement may be reached.



In the meantime, the existing tariffs are having significant impacts on trade. In November 2017, for example, China imported 4.7 million metric tons of soybeans from the US. But in November 2018, Chinese soybean imports fell to zero. China has since indicated that it plans to boost purchases of soybeans and other crops and US exports, but whether that occurs—and whether any such increase would survive past the end of the 90-day truce period—remains to be seen.

2018 also saw a continued decline in Chinese acquisitions of US companies. Chinese acquisitions peaked in 2016 at about \$46 billion, dropped to \$29 billion in 2017, and then plummeted to just \$5 billion in 2018. The adoption of the Foreign Investment Risk Review Modernization Act of 2018 (discussed below and in our article titled “Changes to M&A Resulting from CFIUS Adoption of Pilot Program”) is likely to continue to weigh on Chinese appetite for investments in the United States.

NAFTA Replacement

Closer to home, after more than a year of often contentious negotiations, the US, Mexico, and Canada struck the creatively named United States-Mexico-Canada Agreement (USMCA) on November 30. The USMCA is intended to replace the North American Free Trade Agreement (NAFTA), although the agreement remains subject to ratification by legislators in all three countries. The USMCA is expected to pass easily in Mexico and Canada, but it has been criticized by both Democrats and Republicans in the US. In response, President Trump announced that he would begin a six-month withdrawal period from NAFTA, which would create a deadline for Congress to either ratify the USMCA or let North American trade occur without an overarching trade agreement.

Brexit

It is anyone's guess as to how the long-running Brexit saga ultimately will play out. Britain and the European Union reached a deal in November, but the proposed deal was rejected overwhelmingly by the British parliament in January and again in March. Prime Minister May later survived a no-confidence vote and announced that she would seek to reopen negotiations with the European Union in hopes of avoiding a "no-deal" Brexit. Britain's exit from the European Union is scheduled for March 29, and although the British parliament voted to delay Brexit beyond the current March 29 deadline, any extension of that deadline also would require the unanimous approval of all 27 European Union member countries. The likelihood of an economically damaging no-deal Brexit thus appears increasingly likely, but the situation remains in flux.

US Economic Outlook

In mid-December, the Federal Reserve raised its federal funds target rate to a range of 2.25%–2.5%, the fourth quarter-point increase of 2018, and suggested that it would continue to raise the target rate gradually in 2019. This was the ninth such increase since December 2015, which reflected the Federal Reserve's favorable views on economic growth, job creation and unemployment, and short- and long-term inflation during that time.

At its January meeting, however, the Federal Reserve held rates steady and indicated that it would be patient when considering future interest rate adjustments in light of slowing global growth and volatile financial markets. Notably, for the first time since 2015, the Federal Reserve did not include an explicit reference to future expected interest rate increases. This likely marks the end of the relatively steady increases seen over the last three years, which follows several years of near-zero rates in response to the 2008 financial crisis.

Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act, which was the largest change to the tax code since 1986, was enacted in December 2017. It included a significant reduction in corporate federal income tax rates, the elimination of repatriation taxes, and more favorable rules regarding depreciation of tangible assets acquired from third parties. Many commentators expected these changes to increase corporate cash balances and result in more M&A activity by strategic buyers.

Although the new law may have resulted in some additional M&A activity, the most significant impact seems to have been on stock buybacks. The previous full-year record for buybacks was \$589 billion in 2007, but that record was almost broken in just the first nine months of 2018. Through mid-December, companies had completed about \$800 billion of an announced \$1.1 trillion of buybacks. Buyback activity seems set to continue at elevated levels into 2019, but the opportunity remains for the tax law changes to drive an increase in M&A activity as well.

Private Equity

Private equity funds are another source of dedicated M&A capital, and they finished 2018 with a record \$1.2 trillion of committed but undeployed cash. A similar record also was set at the end of 2017, but it did not translate into a surge of private equity M&A activity in 2018. A recent trend among more-established private equity sponsors is to raise funds with a longer investment horizon—15 or more years as opposed to the more traditional 10 years. This could help support private equity M&A activity during an economic slowdown, as longer-lived funds would have more certainty in their ability to hold portfolio companies until market conditions favor an exit.

Data Privacy

US companies already were subject to a number of state and federal data privacy laws, but the European Union's enactment of the General Data Protection Regulation (GDPR) in May raised the profile of data privacy for both companies' day-to-day operations and their M&A activity. The GDPR, which applies to companies that offer goods and services to individuals in the European Union even if all of their operations are in the US, expanded what most would consider the traditional definition of personal data to include any information relating to an identifiable person. In addition, it gave individuals significant rights over their personal data held by companies. This should cause companies to consider whether collecting data always is beneficial, or if instead it exposes them to significant potential liability—including fines of up to 4% of their global annual revenue—for little benefit.

In the M&A context, the GDPR highlights the increasing importance of data privacy and cybersecurity to the deal process. Acquiring a company with poor data privacy practices, deficient cybersecurity defenses, or a previous data breach could expose the buyer to substantial liability, and conducting thorough due diligence on those issues should be a core component of any buyer's evaluation of a transaction.

Due to the complex and evolving nature of data privacy laws and cybersecurity best practices, technical consultants and legal counsel will need to collaborate to first review the target company's cybersecurity defenses and the extent of any previous breaches, and then determine the scope of any potential liability under the GDPR and applicable US federal and state laws (e.g., see our article below titled "California Consumer Privacy Act and Its Impact on M&A Transactions"). Buyers also must be aware that these issues apply to virtually all target companies, even if their business does not seem to involve significant use of personal data.

FIRRMA

US companies considering sales to foreign buyers will also need to consider the effects of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). FIRRMA expanded the reach of the Committee on Foreign Investment in the United States (CFIUS) to include investments where a foreign buyer acquires influence over a target company that owns critical infrastructure or technology assets or holds the personal data of US citizens rather than only covering transactions resulting in a change of control. In this context, "influence" is defined broadly to include access to material nonpublic information, the right to appoint a director or board observer, and any involvement in substantive decision making of the target company.

In addition, CFIUS filings for certain transactions are now mandatory rather than voluntary, and FIRRMA extended CFIUS's initial investigatory period from 30 to 45 days. The new mandatory filings and longer investigatory period may or may not lead to an increase in the number of transactions reviewed or rejected, but the potential for increased deal execution risk seems clear.

Conclusion

In general, current economic conditions seem favorable for M&A activity, but the outlook is far from clear. For the reasons discussed above, the start of 2019 may be something of an inflection point—if trade concerns dissipate, Brexit concludes smoothly, and market volatility decreases, we should see a rebound in M&A activity from the second-half slowdown in 2018. On the other hand, if these issues continue to weigh on growth and agitate financial markets, dealmakers may delay M&A activity until markets stabilize and political and economic uncertainties are resolved.

2018 M&A Year in Review for Bank Mergers

By Heather Archer Eastep

The year 2018 carried on the improvement in bank M&A activity seen in 2017. The number of transactions, the total deal value, and the median book value multiple per transaction were higher than in 2017. The reasons for increased activity were consistent with the broader markets, including the ability of banks to leverage a higher stock value as merger currency throughout most of the year. The number of deals and capital markets activity declined in the second half of 2018, particularly in the fourth quarter. This can be attributed partially to uncertainty in the stock market and the Federal Reserve's interest rate outlook for 2019. Significant positive developments in 2018, however, are harbingers of a strong bank M&A market throughout 2019.

Transaction Drivers

Carrying over from 2017, buyers continued to seek merger partners with attractive core deposits to offset increasing loan to deposit ratios throughout the industry. On the sell-side, the continued cost of compliance with regulation and supervisory guidance, struggles with net interest margins, and a competitive lending environment from both traditional financial providers and newer fintech providers drove transactions.

Strategic combinations also continued to be a significant driver. Even some of the largest bank deals of 2018 resulted in the acquisition of a target that had long been on the acquirer's short list. These deals offered new, desirable geographic markets or significant in-market cost savings. These strategic transactions were often negotiated deals in which buyers engaged selling institutions that were not actively marketing themselves or being broadly shopped, which is a shift from certain prior years' transactions.

Handled 1,000 M&A transactions worth approximately \$370 billion in the past five years.

“Hunton Andrews Kurth has a very deep bench... they bring the whole package!”

– Chambers & Partners USA, 2018

Bank IPOs also increased in 2018. Although we anticipate bank IPOs continuing to accelerate in 2019, broader concerns of a recession may weaken investor interest in 2019. The increased number of public company banks, however, will keep M&A active in the banking markets as many investors expect expansion strategies. Selling institutions continue their willingness to take not only public company stock as transaction currency, but in many cases also private bank stock—effectively allowing their shareholders to benefit from the synergistic value of the transaction and favorable market conditions in a rising interest rate environment.

Nontraditional bank acquirers also spurred some activity in 2018. Investor groups with fintech-based strategies, particularly those focused on delivering lower-cost consumer retail banking options via new delivery channels, contributed to bank M&A activity in 2018. Uncertainty around the OCC’s fintech charter, however, has not yet made these transactions a popular option for a broader segment of banks. Although traditional de novo banking increased in 2018 as well, “buying-in” to banking remained the preferred route in 2018 rather than forming a new charter.

Legislative Initiatives

In late 2017, President Trump delivered on part of his tax reform initiative, which resulted in an upswing in investment. Combined with consistent economic data around spending and employment, the tax savings of banks led to new strategic initiatives, continuing the bank M&A trend.

President Trump also delivered on regulatory relief for banks in May 2018 with the Economic Growth, Regulatory Relief, and Consumer Protection Act (the Relief Act). The Relief Act has a number of provisions intended to reduce the regulatory burden on community banks that has accumulated since the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act). Relief includes capital simplification through the establishment of a community bank leverage ratio, the default of which is 9%, rather than consolidated capital ratios. Significantly, the Relief Act also increases the size of bank holding companies to which the Federal Reserve’s Small Bank Holding Company Policy Statement applies, from an asset cap of \$1 billion to \$3 billion.



Combined with longer 18-month exam cycles, short form call reports, and consumer compliance reporting relief, the Relief Act is expected to improve the M&A environment for both community banks and regionals.

Despite the Relief Act, the climbing compliance costs that began with the Dodd-Frank Act have continued to escalate for many community banks in the form of regulatory guidance. New agency heads who took the helm in 2018, particularly at the FDIC, have indicated an intent to reform the role of guidance as a supervisory and enforcement tool. Although a significant shift in the mindset of the heads of the federal banking agencies will not result in immediate changes, if the tone at the top is adopted by examiners and supervision staff, the effect could also be reduced compliance costs and greater latitude for capital markets and strategic opportunities.

We are regularly ranked as a top advisor in SNL Financial’s league tables for bank and thrift legal advisors.

Oil & Gas...and Water!

By Parker Lee

2018 was a banner year for M&A activity in the energy space, with numerous high-dollar-value transactions in the upstream, midstream, downstream, and oil field services (OFS) segments. As investors in the public securities markets have shown a significantly decreased appetite for new issuances of equity by energy companies, the preferred exit or growth strategy for 2018 has been through strategic mergers, acquisitions, or divestitures. These transactions have manifested themselves in various forms: asset acquisitions and divestitures, private equity investment into “drillcos” with strategic oil and gas companies, public-public mergers between OFS companies and upstream shale drillers, and simplification transactions by master limited partnerships (MLPs) in the midstream space. In addition to all of this M&A activity, one element has become significantly more prevalent in the oil and gas industry throughout 2018 and shows no signs of letting down for 2019: water.

In the oil and gas operational context, water is ever-present and companies are focusing on manners in which water, and companies that transport, dispose of, treat, and sell water, can be monetized. When oil and gas is produced from an underground reservoir, high volumes of water (usually salt water mixed with particles of hydrocarbons) rushes up to the surface with extracted oil and/or gas. This water is called produced water. In an effort to provide the purest forms of oil and gas for transportation, producers separate the oil and gas from each other and also remove as much produced water as possible. Typically, once oil, gas, and water have been separated from each other they are transported from the wellhead to a gathering system. A gathering system is a set of pipelines connected to the well area on one end and a downstream facility or pipeline on the other end, which then further transports those products to additional separation, processing, or terminalling facilities before delivery to long-haul pipelines that transport the products farther away for additional refining and ultimately for sale and consumption. This activity of transportation from the wellhead to consumption is what is typically referred to as the midstream segment of the oil and gas industry.

The midstream business is well established and has a long operating history. Many midstream companies over the past few decades have been organized as MLPs, and we as a firm were instrumental in structuring one of the initial MLPs as we represented Transco Energy Company in the formation and initial public offering of Transco Exploration Partners Ltd. (the

first IPO by an MLP) in 1983. Hunton Andrews Kurth lawyers have advised on countless MLP transactions in the M&A and securities context ever since. Water is quickly becoming the third leg of the stool for the midstream sector, alongside oil and gas. Experienced transporters of oil and gas are able to use their expertise and existing physical (pipelines) and contractual (rights of way) infrastructure to install pipelines to transport, store, and dispose of produced water, all for a fixed fee based on the volume of water transported. Much of the contractual architecture from oil and gas gathering agreements can be implemented in produced water gathering agreements, all making for a relatively easy way for the midstream companies to generate additional revenue and for upstream companies to efficiently manage their volumes of produced water.

But this need to transport produced water has been around as long as oil and gas have been produced, so what has changed to make produced water so interesting to midstream companies and investors alike?

Primarily, there has been a substantial increase in US oil and gas production over the last decade, and this has led to higher volumes of produced water for transportation and disposal, and saturation of existing produced water disposal sites. This presents logistical and cost issues for producers, so the ability and interest of midstream businesses to take on more produced water has been a welcome development and provides an opportunity for producers to monetize these water assets.

Another answer lies in the rise of hydraulic fracturing, or “fracing” as it is colloquially known. Fracing a well requires a large volume of water that is injected back into the reservoir, along with proppants, to stimulate the fracturing of particles of rock, allowing for oil and gas contained therein to be released. Who better to transport and provide this fracing water than the midstream companies that are already handling produced water and connected to much of the producers’ existing infrastructure? To be clear, the water (in the fracing context, known as “fresh water”) involved in fracing is of a much cleaner specification than produced water, so it is not as easy as turning around and handing produced water back to producers to use for fracing. But midstream companies have proved resourceful in that they will take large volumes of produced water, recycle and treat that water, often blend it with fresh water (usually from local fresh water wells), and redeliver that end product to producers for use in fracing for a nice fee along the way. This creates an entirely new revenue stream for midstream companies involved in transporting produced water, and can typically be achieved through economies of scale due to existing ownership or possession of the raw product,

materials, and physical presence near the receipt point of produced water and delivery point of water for fracing.

As legal counsel for numerous upstream and midstream companies, we have seen a significant uptick in the portion of our time spent on preparing produced water gathering agreements and water distribution and services agreements as our midstream clients pivot their focus toward water. What generally remains to be seen is when and how companies will seek to monetize their water assets. There have already been a handful of water-specific M&A transactions in the energy space that have come in the form of water-focused companies (typically private equity portfolio companies) acquiring produced water infrastructure from upstream producers or integrated oil and gas companies, as well as numerous equity commitments from private equity firms to water-focused midstream portfolio companies to support future water acquisition activity. There also appears to be real potential for water transactions in the public securities markets, whether it be through initial public offerings of water companies as traditional corporations or through a water-focused MLP. While the public energy MLP market has struggled over the past few years, it will be interesting to see if a water MLP would appeal to public investors' changing appetites as an alternative to traditional midstream MLPs. The conventional wisdom (and there is a private letter ruling supporting this thought) is that the combination of transporting produced water and distributing fresh water meets the standard for qualifying income and thus is eligible for MLP treatment.

BJ Walker, an executive director at energy-focused investment bank Tudor, Pickering, Holt & Co. (TPH) and a leader in TPH's water advisory practice, believes that the next five years are likely to provide for numerous water midstream transactions as water-focused midstream businesses attempt to grow and aggregate water assets. Where the initial wave of midstream water transactions occurred through "drop-down" transactions from upstream parent companies into their affiliated MLPs, Mr. Walker is seeing more of a trend toward midstream water assets' being acquired by the portfolio companies of private equity and infrastructure funds. An important part of this trend will be the continued development of reliable commercial contracts for water transportation. These agreements need to resemble true arm's-length transactions to provide buyers and public investors comfort in the security of the revenue stream underlying those agreements. And while M&A is likely to be the current form of water midstream transactions, Mr. Walker thinks the ultimate monetization of water midstream assets

could be the public equity markets, whether that be through a C-corp structure or an MLP.

In addition to oil- and gas-related water activity, we have also seen a rise in transactional activity in the regulated water space. We have worked with a number of water-focused strategic companies and private equity firms on a range of activity from development of water transportation infrastructure for large municipalities' supplies of drinking water to a joint venture for acquisitions of small, rural water provision and wastewater treatment facilities. It is clear that investors see the potential for profit in consolidation and/or scaling up of water businesses.

Whether through M&A deals or capital markets activity, we expect to see a significant increase in water-related transactions in 2019. Due to water's unique characteristics as a regulated commodity, an oil and gas byproduct, and a component of fracing solutions, the players involved in the water market run the gamut from oil and gas producers, industrial waste businesses, oil field service companies, and infrastructure/private equity firms. There is a lot of interest in the space and lots of parties involved. Our varied and extensive experience with water in the oil and gas and regulated utility space gives us deep knowledge of the market and the players involved, and we look forward to continuing to grow our presence as a leader in water transactions.

Our internationally preeminent energy practice unites a tier one oil and gas practice with a tier one power practice.



Deal Focus - Pebblebrook Hotel Trust Acquisition of LaSalle Hotel Properties

Pebblebrook Hotel Trust's \$5.2 billion acquisition of LaSalle is a rare example of a successful hostile takeover of a Maryland REIT. Despite Maryland's target-friendly corporate law regime, this transaction demonstrates that being at war with your shareholders is always a risky position. We represented Pebblebrook in the transaction, whose CEO Jon Bortz will take over LaSalle, which he founded in 1998 and ran until he founded Pebblebrook in October 2009.

Through a series of public announcements and a patient, long-term strategy executed over six months, Hunton Andrews Kurth partners Steven Haas and Mark Wickersham were able to leverage shareholder pressure on LaSalle to eventually lead to its capitulation and sale to Pebblebrook. In response to Pebblebrook's public proposals that put the spotlight on LaSalle, LaSalle entered into a merger agreement with another buyer. While LaSalle attempted to secure shareholder approval for that transaction, Haas and Wickersham led an aggressive campaign to solicit proxies against LaSalle's preferred deal. Ultimately, citing Pebblebrook's "superior proposal," LaSalle terminated its agreement with the initial buyer and entered into a new merger agreement with Pebblebrook. The takeover, which was completed in November 2018, resulted in Pebblebrook's becoming the third-largest lodging REIT by enterprise value and the owner of the largest number of independent/lifestyle hotels in North America.

Haas, co-head of Hunton Andrews Kurth's M&A team, represents major corporations on a wide variety of M&A transactions and regularly advises companies and boards of directors on corporate governance, shareholder activism, and other fiduciary duty matters. A fellow of the American College of Governance Counsel, Haas is nationally recognized for his experience and is a frequent speaker and writer on corporate governance matters. Wickersham, a former Goldman Sachs analyst and BCG consultant, has extensive experience advising public and private REITs in corporate and securities transactions. He has represented Pebblebrook since its formation and, among other clients, advises four other public hospitality REITs.

Retail M&A in 2018

By Scott Kimpel and Candace Moss

Overview

In 2018, global M&A activity hit record levels. However, the number of deals declined by 9% compared to 2017, representing the lowest deal volume in three years. Based on target industry, the consumer products and services industry and the retail industry each represented 4% of total worldwide announced M&A.¹

According to reports by PwC, for US consumer markets M&A activity in 2018 there was a year-over-year decrease in announced deal volume of 10.6% and a decrease in announced deal value of 20.4%. Based on sector category within consumer markets, for the consumer sector, there was an increase in total deal value of 39.8% and a decrease in total deal volume of 7.5% compared to 2017. The retail sector experienced a decline in total deal volume of 17.1%, while total deal value decreased significantly by 61.5%. The top three consumer markets subsectors in 2018 based on announced deal value were food and beverage (\$67.8 billion), other consumer products (including products such as appliances, furniture and consumer electronics) (\$47.8 billion) and grocery, drug, discount and mass (\$21.2 billion). The top three subsectors based on the number of announced deals were other consumer products (365 deals), food and beverage (306 deals) and specialty retail/other (including electronics, home improvement, auto repair and other categories) (257 deals). In 2018, the distribution of deals by transaction size remained similar to 2017, with smaller transactions of \$50 million or less continuing to account for a majority of total deals (55% of deals, compared to 54% of deals in 2017).²

¹ http://dmi.thomsonreuters.com/Content/Files/3Q2018_MA_Legal_Advisor_Review.pdf

We have acted as counsel on more than 60 REIT M&A transactions aggregating more than \$70 billion.



Looking Ahead to 2019

Although M&A activity continues to be strong, factors such as global trade policy and market volatility could affect deal volume in 2019, including throughout the consumer and retail sectors. Tensions between the US and its traditional trading partners and the impending Brexit all threaten to negatively impact M&A, particularly cross-border deals. Despite this economic uncertainty, a Deloitte 2019 M&A trends report shows that there is still a healthy appetite for M&A heading into 2019, with 76% of domestic corporate M&A executives and 87% of domestic private equity M&A executives expecting the number of M&A deals to increase over the next year, and 70% of executives expecting an increase in average deal value.

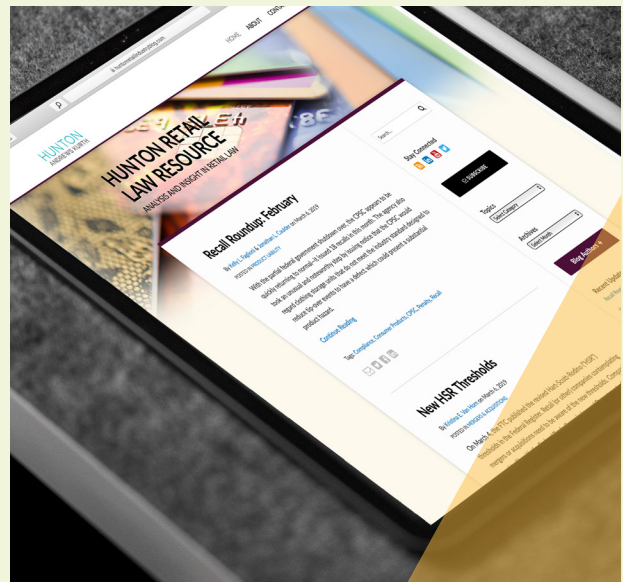
Notwithstanding some unfavorable global trade policy developments, corporations and private equity firms still view Canada and China as the top most likely international markets for M&A. The lingering impact of tax reform and increased corporate savings could also encourage deal activity, and buyer interest in consumer products and retail targets remains high. Overall, while at first glance market conditions may appear to be poised to slow down M&A activity, there is reason to remain optimistic that there will not be an immediate sharp decline, as companies and private equity firms still seek to engage in strategic transactions, particularly in the retail and consumer sectors.

² <https://www.pwc.com/us/en/industries/consumer-markets/assets/pwc-cm-deals-insights-q4-2018-final.pdf>

Hunton Retail Law Resource Blog

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Written by members of our firm's experienced team of lawyers who serve retailers from factory floor, to retail outlet, to online store, Hunton Retail Law Resource blog helps you stay abreast of the legal and regulatory issues facing your company and helps you minimize risk in this highly competitive and ever-changing industry. With a regular digest of breaking legal news and information delivered to your desktop, our blog reports cover topics including corporate law, FTC and SEC consumer protection and antitrust matters, labor law, litigation, retail class actions, and privacy and cybersecurity. Subscribe now to the Hunton Retail Law Resource blog for the latest legal updates, developments and business trends that affect your retail business.



Changes to M&A Resulting from CFIUS Adoption of Pilot Program

By Eric Markus and Leslie Kostyshak

In August 2018, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) became law. FIRRMA made a number of changes to the substance and procedures applicable to national security reviews of foreign investments in the United States. The most significant of these changes were the directions given to the Committee on Foreign Investment in the United States (CFIUS)—an interdepartmental body of the federal government with authority to review transactions with national security implications—to include certain *noncontrol* transactions in the ambit of CFIUS review and to make certain submissions to CFIUS *mandatory*.

Expansion of Covered Transactions

Under the law and regulations in effect prior to FIRRMA, a transaction was “covered”—subject to CFIUS’s authority—only if it could result in “control” of a US business by a foreign person. Control was defined broadly; however, the control definition specifically carved out investments where the investor acquired less than 10% of the US target’s stock and did so “solely for the purpose of passive investment.” Further, the official commentary made it clear that a foreign person that had a small investment (but greater than 10%) and the right to appoint a single director likely would not be deemed to “control” the business absent other facts.

On October 10, 2018, the US Department of Treasury published a set of “Pilot Program” rules, without notice or opportunity for public comment, that implement (on a temporary basis) certain of the FIRRMA provisions that had directed CFIUS to extend its review to certain noncontrol transactions and to make approval mandatory for certain transactions involving national security. These new, temporary rules are generally effective for all transactions occurring after November 10, 2018 (and will expire on March 5, 2020).

The Pilot Program creates a new type of transaction—called “a pilot program covered transaction”—that is subject to CFIUS’s authority. This category includes some transactions that would be “covered transactions” under the non-Pilot Program rules as well as some transactions that would not. A pilot program covered transaction has to satisfy three criteria:

- First, the US target business involved must be producing, designing, testing, manufacturing, fabricating, or developing a “critical technology.” A critical technology is defined as: (a) defense articles or defense services controlled by the International Traffic in Arms Regulations; (b) items controlled by the Export Administration Regulations (1) pursuant to multilateral regimes relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation, and missile technology, or (2) for reasons relating to regional stability or surreptitious listening; (c) specially designed nuclear equipment, parts and components, materials, software, and technology; (d) nuclear facilities, equipment, and material; (e) certain poisonous agents and toxins; and (f) emerging and foundational technologies.
- Second, the critical technology must be either utilized in connection with the US business’s activities in one or more of 27 specifically identified “pilot program industries” or designed by the US business for use in one or more such industries. These industries are designated by North American Industry Classification System (NAICS) codes. With only a few exceptions, all of these targeted industries involve manufacturing, alloying, or smelting of some kind. The nonmanufacturing sectors are nuclear electric power generation and research and development of nanotechnology and biotechnology.
- Third, the transaction must be one that could result in the foreign party’s acquiring “control” of the US business under the non-Pilot Program rules or that otherwise constitutes a “pilot program covered investment.” A pilot program covered investment is defined as any *direct or indirect* equity interest that does not amount to control but that affords the foreign party (a) access to any material nonpublic technical information in the possession of the US business; (b) membership or observer rights on the board of directors or equivalent governing body of the US business (or the right to nominate an individual to a position on such governing body); or (c) any involvement, other than through voting of shares, in substantive decision-making of the US business regarding the use, development, acquisition, or release of critical technology.

Thus, where critical technology in one of the specified 27 industries is involved, CFIUS’s authority to review a transaction has been expanded to include *direct and indirect* equity investments of any size or percentage that provide

certain access or rights to information or involvement but nevertheless something less than control. This reflects the government’s concern that certain foreign buyers are acquiring noncontrolling interests in businesses with important technologies and are doing so for the purposes of gaining knowledge of and insight into those technologies.

“They provide impeccable client service, great value for money, great billing transparency and flexibility.”

– *Chambers & Partners USA*, 2018

Private Equity Safe Harbor

By expanding CFIUS’s authority to include noncontrolling investments in particular industries by foreign persons where they have board or related rights, FIRRMA opened up the possibility that a foreign investor with board or related rights in a private equity fund investing in a US business could constitute (indirectly) a pilot program covered transaction and be subject to mandatory review by CFIUS. The private equity industry successfully lobbied for a safe harbor exception so that foreign investors with board or related rights in private equity investment vehicles would not give rise to pilot program covered transactions where the investment vehicle meets certain conditions.

The relevant rule provides that an *indirect* investment by a foreign person in a US business through an investment fund where the foreign person (or a designee) serves on an advisory board or committee of the fund will not be considered a pilot program covered investment by virtue of the foreign investor’s indirect ownership interest if four criteria are met:

- First, the investment fund is managed by a general partner or equivalent that is not the indirect foreign investor.
- Second, the advisory board or committee of the fund does not have the ability to approve, disapprove, or otherwise control, directly or indirectly, the fund’s investment decisions.

- Third, the foreign person does not otherwise have the ability (i) to approve, disapprove, or otherwise control, directly or indirectly, the fund or its investment decisions or (ii) to unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner or equivalent of the fund.
- Fourth, the foreign person does not have access to material nonpublic technical information as a result of its participation on the advisory board or committee.

Mandatory Filing with CFIUS

Under the law and regulations in effect prior to FIRRMA and the Pilot Program, it was entirely lawful to close a transaction without first seeking or obtaining approval from CFIUS, though taking such an approach could be unwise. If a foreign buyer acquired control of a US business that could affect US national security without obtaining CFIUS clearance, there was no violation of law under the laws in effect prior to FIRRMA, but there was always the risk that CFIUS would demand the parties file a post-closing CFIUS notice as well as the risk that the president could force the buyer to divest its acquired interest at any time. Thus, closing a transaction without CFIUS clearance did not cause the parties to be subject to penalties and the risks of completing such a transaction appear to have fallen primarily on the buyer.



“The team worked very, very well. I liked their open-minded attitude - they were keen to accept comments and act accordingly, and it was a nice environment in which to work.”

– Chambers & Partners USA, 2018

Under the Pilot Program rules, however, CFIUS has established for the first time a *mandatory* filing with CFIUS for all pilot program covered transactions.³ For transactions closing after December 25, 2018, the filing must be made at least 45 days before completion. The required filing can be either the current “notification” or on a new, shorter “declaration” form. Under the Pilot Program, if the buyer and seller fail to file a notice or declaration prior to closing, each could be assessed a penalty of an amount up to the value of the transaction in question for failing to obtain CFIUS clearance before closing. Thus, the failure to seek clearance for pilot program covered transactions poses significant risks for *both the buyer and the seller*.

Effect on M&A Practice

For control transactions in defense and other industries where there are clear and substantial national security concerns and that involve foreign buyers, the Pilot Program likely will not change M&A practices very much. The foreign buyers involved in such transactions—whether from nations that have been heavily scrutinized by CFIUS (e.g., China) or other nations—would likely have sought CFIUS approval prior to the Pilot Program and will continue to do so post-FIRRMA. To the extent that there are buyers in this category that might not have sought CFIUS approval prior to FIRRMA due to a very close relationship between the United States and the buyer’s home country (e.g., buyers based in Canada or the United Kingdom), we would expect them to seek CFIUS approval if the transaction is a Pilot Program covered transaction.

For control transactions in industries where the national security concerns are less clear and less substantial and that involve foreign buyers, the Pilot Program likely will not change M&A practices very much if those buyers have a *high degree of confidence that the transaction would not be covered by the Pilot Program*. For buyers and sellers in this category, the existence of the Pilot Program is unlikely to influence parties to file a transaction and the propensity to file will ordinarily depend on the parties’ risk preferences, the nationality of the buyer, and the industry in which the target operates.⁴ However, where such a control transaction is clearly subject to the Pilot Program, we expect to see an increase in CFIUS submissions.

Finally, for noncontrol transactions, the Pilot Program opens up an entirely new category for CFIUS review. After FIRRMA, (a) where a noncontrol transaction involves an investment of any size by a foreign person in a business involved in producing, designing, testing, manufacturing, fabricating, or developing a “critical technology” for use in one of the 27 “pilot program industries” (or in those instances where the parties are unable to make a reliable determination as to such matters⁵) and (b) where the buyer/investor could have access to material nonpublic technical information as a result of its involvement, the parties can be expected to seek CFIUS clearance. Moreover, if any investment funds are involved in the transaction, the parties will have to look closely at the rights of the investor in the US business and terms of the investment fund’s offering and/or organizational documents to determine its sources of funding and whether its offering and/or organizational documents have been structured to meet the requirements of the private equity safe harbor.

³ FIRRMA specifically authorized CFIUS to adopt regulations that differentiated between the nationality of foreign buyers as it relates to critical technologies. However, CFIUS did not take advantage of this authority in the Pilot Program rules.

⁴ In this regard, we have seen a number of merger and acquisition agreements that have been publicly filed on EDGAR since the adoption of the Pilot Program rules where the agreements do not provide for the filing of a notice to CFIUS *but where the seller represents in some form that it does not operate in a Pilot Program industry and/or that it does not manufacture or develop critical technologies*.

⁵ The possibility of being unable to determine with certainty seems to be unlikely where the target is directly involved in a transaction as it should know—or be able to determine—whether it is in one of the 27 identified industries and/or whether it manufactures critical technology. However, where the US target company is not itself a party to a transaction (e.g., where one stockholder is selling to a third party), the parties to such transaction may lack the resources and information to make a reliable Pilot Program covered transaction determination.

Antitrust Enforcement Still Unpredictable Under Trump

By Kristina Van Horn

After a slow start in getting Senate-confirmed appointees in place, both the Department of Justice's Antitrust Division and Federal Trade Commission finally got their full complement of senior leadership in place in September 2018. Chairman Joe Simons and Commissioner Christine Wilson returned to the FTC as commissioners after years of private practice, and other major commission roles have been filled by FTC alumni. Similarly, the Antitrust Division leadership has a number of attorneys with prior government experience.

This seasoned leadership, however, has not made antitrust enforcement more predictable. This uncertainty is even more pronounced in "vertical" deals involving companies that are at different levels of the supply chain. Both the FTC and DOJ spoke out early in the Trump administration against behavioral remedies which have been used in the past to mitigate risk of harm to competition from vertical deals.⁶ Absent imposing behavioral remedies like those in Comcast/NBCU, the Antitrust Division, for example, challenged the proposed vertical transaction involving AT&T and Time Warner. This uncertainty is also present in horizontal deals involving direct competitors: Some deals are getting inquiries where none were expected and some are being cleared when we expected inquiries.

On a more positive note, both the FTC and Antitrust Division have focused on process improvements. In response to increasing time, expense, and burden of government antitrust investigations, both agencies have announced initiatives to speed up the review process for proposed mergers.⁷

Several major retail mergers made headlines in 2018 and provide lessons for merging parties in 2019.

- **J.M. Smucker's attempted acquisition of the Wesson cooking oil brand from Conagra** was abandoned by the parties after the FTC challenged the merger. The FTC alleged that the combined Smucker's, which already owns the Crisco brand, would control at least 70 percent of the market for branded canola and vegetable oils sold to grocery stores and other retailers. The FTC also alleged that Smucker's own documents showed that eliminating price competition between Wesson and Crisco was a central part of the rationale for the deal. Interestingly, the FTC did not include private label cooking oils in its relevant market definition

despite the fact that private label products account for a majority of cooking oil sales to retail consumers. Three days after the FTC filed for a preliminary injunction, the parties abandoned the deal.

- **AT&T's acquisition of Time Warner** was challenged by the Department of Justice in late 2017. After a full trial on the merits of the proposed acquisition, federal district court Judge Richard Leon approved the deal in June 2018 and the parties closed on the transaction soon thereafter. After initially saying that it would not challenge Judge Leon's decision, the DOJ appealed to the DC Circuit. On February 26, 2019, the DC Circuit upheld Judge Leon's decision.

With two major mergers now facing additional scrutiny, 2019 is sure to bring additional drama to the antitrust landscape.

⁶ Asst. Att'y. Gen. Makan Delrahim, Keynote Address at American Bar Association's Antitrust Fall Forum (Nov. 16, 2017) (noting a plan to "return to the preferred focus on structural relief to remedy mergers," Bureau of Competition Acting Director D. Bruce Hoffman, "Vertical Merger Enforcement at the FTC," (Jan. 10, 2018) ("First and foremost, it's important to remember that the FTC prefers structural remedies to structural problems, even with vertical mergers.")).

⁷ Asst. Att'y. Gen. Makan Delrahim, "It Takes Two: Modernizing the Merger Review Process," Remarks Before the 2018 Global Antitrust Enforcement Symposium (Sept. 25, 2018); Bureau of Competition Director D. Bruce Hoffman, "Timing is everything: The Model Timing Agreement" (Aug. 7, 2018), available at <https://www.ftc.gov/news-events/blogs/competition-matters/2018/08/timing-everything-model-timing-agreement>.

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– Working Mother Media, 2018

Trends for Distressed Transactions and Restructurings in 2019

By J.R. Smith and Justin Paget

As 2018 closed out with building economic headwinds brought on by a burgeoning trade war and continued challenges for retailers, 2019 may provide numerous opportunities for distressed transactions and corporate restructurings.

Retail bankruptcies once again dominated the headlines in 2018, led by the swift and high-profile liquidation of Toys “R” Us a mere six months after commencing Chapter 11 bankruptcy. Citing lackluster sales during the 4th quarter of 2017 and an inability to obtain covenant relief from certain of its secured lenders, Toys was forced to terminate its domestic operations unexpectedly without any alternative restructuring options on the table. The Toys bankruptcy was a rare case study on a “free fall” retail bankruptcy, testing how the provisions of a secured post-petition lending facility that favor the secured lenders interplay with Bankruptcy Code protections afforded to vendors, suppliers, landlords, and other unsecured creditors who continue to do business with a large corporation operating in bankruptcy. The case ultimately resulted in a consensual liquidation plan for the Toys’ domestic operations with the secured lenders sharing value with certain unsecured creditors that provided trade credit to Toys post-petition. Of note, the bankruptcy court approved a mechanism bifurcating administrative claims into two buckets: those receiving 100% and those receiving less. Whether this approach becomes a trend, surviving legal challenge, remains to be seen. But it puts significant stress on vendors of debtors and the ability of debtors to emerge as going concerns.



Although long anticipated by the marketplace, iconic department store Sears Holdings Corp. filed for Chapter 11 in October 2018 with more than \$18 billion in debt. There is much uncertainty about whether Sears will avoid a liquidation by accepting a bid to keep a limited number of stores open. Hedge fund ESL Investments Inc., owned by former Sears CEO Eddie Lampert, currently is seeking to acquire hundreds of Sears and Kmart stores through a bankruptcy sale and credit bid process, but the bid faces objections from unsecured creditors. On February 7, the bankruptcy court approved a revised bid from Lampert over competing bids from a consortium of liquidators, overruling objections from various third-parties. Approval of the bid paves the way to preserving jobs for thousands and some of the going concern value in this iconic brand. Lampert himself still faces possible creditor litigation for transactions he orchestrated prior to the bankruptcy filing. Whether Sears’ fate ultimately will follow Toys remains to be seen as Lambert has not outlined a turnaround plan, but the company is quickly running out of capital with more than 50,000 jobs in the lurch.

It is possible that we have crossed the high-water mark for retail bankruptcies. Large retail company restructurings in 2018 fell slightly from the prior year. While competition among retailers remains fierce, many traditional brick-and-mortar retailers have either succumbed to market pressures or have evolved by developing cost-cutting measures or shifting significant portions of their businesses to the online marketplace. Blurring the line between old and new, many successful retailers now employ a mix of online and brick-and-mortar channels. The future of retailing will look to technology innovations and successful management of this mix of online and physical locations to maximize consumer reach and brand recognition while minimizing traditional costs. Underscoring this trend, Amazon anticipates opening thousands of brick-and-mortar “cashless” stores in the coming years to channel its e-commerce dominance.

As a result of the China-US trade war, there nevertheless remain significant threats over the next year to companies that depend on importing or exporting raw materials or finished products. In response to escalating US tariffs on billions of dollars of Chinese-made exports, China has reciprocated with tariffs on \$60 billion of US imported goods, including steel and aluminum. Currently subject to a 90-day standstill, these tariffs are set to escalate in a few months if the two sides cannot reach a global trade deal. The Trump administration also has sought to negotiate or renegotiate major trade deals, such as NAFTA. The long-term impact of a prolonged trade war on corporate earnings remains unclear,



but it threatens a wide swath of sectors, not just raw material manufacturers. For example, Apple downgraded its first quarter revenue guidance by \$5–\$9 billion, shouldering much of the blame on the economic environment in China, in part a result of rising trade tensions with the United States. Tariffs also could spur more automotive, retail, and agriculture Chapter 11 filings in 2019.

Rising interest rates caused by sharp increases to the federal funds rate by the Federal Reserve impacted mortgage lending and real estate demand in the latter half of 2018. The Fed has recently signaled a slowing in the pace of interest rate hikes, but still projects two more rate hikes in 2019. Nevertheless, a flattening yield curve—with the spread between the two-year and ten-year treasury rates falling to as close as 0.1 percentage points—has set off further alarm bells. A flat or inverted yield curve, sharply reducing bank profits, can signal that a recession is not far off.

All of these risks on the horizon appear to have precipitated extreme levels of stock market volatility during the last three months of the year. Many analysts predict such volatility to continue into much of 2019. Yet, a domestic or global recession may not be a foregone conclusion. In contrast to the recession of the last decade, housing prices and inventory did not experience a comparable “bubble” in the 2010s. In fact, mortgage applications ticked up at the end of 2018 with the decline in mortgage rates due to stock market volatility and a corresponding fall in interest rates. Softness in the real

estate market may persist into 2019, depending upon the Fed interest rate decisions, but the lack of overbuilding during the past decade suggests that if a recession occurs in the coming year it may not be primarily attributable to real estate.

At a minimum, uncertainty and volatile markets attributable to fluctuating oil prices, interest rates, and trade wars point to another active year ahead for restructuring. There are several pending cases and legislation that could impact companies that seek to restructure in the short to medium term.

In October 2018, the US Supreme Court accepted a case concerning whether the owner of a trademark license may revoke the right of licensees to use the trademark if the owner files bankruptcy. This issue arose in the case of apparel retailer Mission Product Holdings Inc. and has ramifications for large retailers who depend on protecting the strength of their brands through a restructuring. Of course, Congress could elect to amend the Bankruptcy Code to specify how trademarks are treated in bankruptcy, but congressional action may prove difficult with a divided government in the new year.

There is pending legislation that, if enacted, would revamp the bankruptcy process for small businesses. Congress has proposed a bipartisan bill that would streamline bankruptcy filings for businesses with less than \$2.5 million in debt. Included are new tools to boost the chances for a successful restructuring for roughly 90% of companies that file for Chapter 11 protection. For example, under the proposed bill, small business debtors could forego the expensive and time-consuming process of filing a disclosure statement and soliciting the votes of creditors for a bankruptcy plan. Certain aspects of the bill resemble the bankruptcy process for consumers who file under Chapter 13. Enactment of the bill would make filing bankruptcy much more attractive to small business owners who wish to restructure their businesses while maintaining ownership of the company upon emergence.

Hunton Andrews Kurth boasts 25 lawyers in its bankruptcy, restructuring, and creditors’ rights practice group with a wealth of experience representing debtors, creditors, and other parties in many large and complex corporate restructurings, including recent prominent cases such as Toys “R” Us, Payless Shoes, Gymboree Corporation, Sears Holdings Corp., Westmoreland Coal Company, SunEdison, and Tops Friendly Markets.

More than one-third of the current Fortune 100 are among our clients

Corporate and Securities Litigation Trends

By Eric Feiler and Johnathon Schronce

In the last few years, Delaware courts issued several decisions that have had a significant effect on shareholder lawsuits that seemingly followed the announcement of every public company merger. Most notably, in *In re Trulia, Inc. S'holder Litig.*, 129 A.3d 884 (Del. Ch. 2016), the Delaware Court of Chancery rejected a disclosure-only settlement, condemning the “flurry of class action lawsuits” that followed the announcement of every public company deal that frequently served “no useful purpose for stockholders.”

Despite these developments in Delaware, shareholder challenges to mergers are still an all too familiar occurrence. Although the rate of lawsuits has fallen somewhat—according to Cornerstone Research, only 73% of public company deals valued over \$100 million drew a lawsuit in 2017, down from 94% in 2013—many of those lawsuits have simply migrated to federal court in the form of claims under the federal securities laws. As a result, public companies remain well advised to prepare for the possibility of litigation as the deal process unfolds.

Trulia and Its Impact

In *Trulia*, the Delaware Court of Chancery rejected a proposed disclosure-only settlement. Rather than simply taking issue with the substantive quality of the supplemental disclosures, the court issued a broader statement about the way these cases had been previously handled, noting that the proposed settlement failed to provide Trulia’s shareholders with “any economic benefits.” Indeed, the only economic benefit was to be the fees paid to class counsel for obtaining additional disclosures for the shareholders. Going forward, the court explained that it would be “increasingly vigilant” in policing such settlements, with court approval likely to be denied “unless the supplemental disclosures address a plainly material misrepresentation or omission.” Given that this very settlement model had been routinely approved in the past, *Trulia* sent shockwaves through the plaintiffs’ bar.

The effects of *Trulia* can be seen in litigation statistics since the decision. In the two years following the decision, the number of merger suits filed in Delaware declined from more than half of all such suits in 2015, to one-third in 2016, to less than 10% in 2017. Not only did plaintiffs flee Delaware following *Trulia*, they have also fled state courts, presumably concerned that any court applying Delaware law would follow the decision. In 2013, less than one-third of merger lawsuits

were filed in federal court. In 2017, 87% of those suits were filed in federal court. Indeed, according to Cornerstone Research, merger-related lawsuits comprised nearly half of all federal securities class actions filed in 2017.

The Shift to Federal Court

With the shift to federal court has come a shift in the type of claims plaintiffs typically bring. Whereas plaintiffs previously focused on claims for breach of fiduciary duty under state law, federal lawsuits typically include claims under the federal securities laws—primarily Sections 14(a) and 14(e) of the Exchange Act. Such claims are based purely on the adequacy of the disclosures rather than the price or sale process. And like state law claims brought in Delaware, they carry with them the threat of an injunction to block a shareholder vote—the leverage plaintiffs exploit to extract settlements and attorneys’ fees.

For several reasons, however, these claims are generally more difficult for plaintiffs than the state law claims that they typically brought. First, the standard for what must be disclosed is different under Delaware law and federal law. Under Delaware law directors are charged with disclosure of all material information. Although the standard for determining materiality is the same under Delaware and federal law, federal law requires more: SEC rules must require disclosure of the omitted information or the omitted information must make the existing disclosures false or misleading.

50,000 hours contributed to community-service and charitable projects annually

Second, the Private Securities Litigation Reform Act (PSLRA) applies to private claims under the federal securities laws. These reforms were specifically designed to curb “nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and manipulation by class action lawyers of the clients whom they purportedly represent.” *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 US 71, 81 (2006). The PSLRA carries with it heightened pleading standards, requiring a plaintiff to plead *with particularity* each statement alleged to have been misleading and the reasons it is misleading. Plaintiffs’ favored approach, at least early in merger litigation, is to plead a laundry list of information that could have been included in the proxy but was not. That may suffice under the liberal pleading

standards of most states, but it is not sufficient under the PSLRA. The PSLRA also requires plaintiffs to plead that the alleged misstatement or omission caused the economic loss plaintiffs seek to recover in the litigation.

Third, at least some federal courts have expressed the same sort of skepticism of strike suits as *Trulia*. In *In re Walgreen Co. S'holder Litig.*, 832 F.3d 718 (7th Cir. 2016), the Seventh Circuit decried the frequency of merger-objection strike suits, noting that they typically result in a “settlement in which class counsel receive fees and the shareholders receive additional disclosures” that “may be largely or even entirely worthless.” Expressly endorsing *Trulia*, the court reversed a district court opinion approving a disclosure-only settlement.

What Does It Mean?

The rate of merger strike suits has fallen since *Trulia*. But the *Trulia* decision and the host of obstacles to a successful claim under the federal securities laws have not brought about an end to the strike suits that have become so commonplace in the last 15 years.

Given the ubiquity of merger suits, it is unlikely that a board can avoid such a suit altogether. Whether facing a merger challenge in Delaware, in federal court, or some other state, the best defense to such a claim is a good process and robust disclosure. It is imperative that corporate boards enlist experienced deal counsel early on in a transaction to guide them through the process and assist in preparing disclosures. It is also important for the board and deal counsel to work with seasoned litigators throughout the process to identify potential issues and to read the disclosures with an eye toward defending them in court.



Checking in on Tax Reform and Looking Ahead to 2019

By Thomas Ford, Robert McNamara, and Adam Mechanic

In 2018, we saw an impressive amount of M&A activity, both in the US and internationally, due in part to the Tax Cuts and Jobs Act (the Tax Act)—the US tax reform bill that became law as we closed out 2017. Through an increase in cash balances and incentives for domestic investment, the Tax Act appears to have played a role in stimulating M&A activity in 2018 and, subject to the struggles facing the world economy in the months to come, these trends should continue in 2019.

Cash Repatriation to the US

Prior to enactment of the Tax Act, US businesses generally were taxed on their worldwide income, but with important exceptions. For example, active business income earned by foreign subsidiaries was generally not subject to US tax until actually repatriated to its US shareholders as dividends. This worldwide tax system led to a “lock-out” effect whereby US taxpayers—generally, large US multinational corporations—had an incentive to keep earnings offshore in order to defer US income tax.

In an effort to spur an influx of cash currently held overseas, the Tax Act sought to move away from our old international tax system by imposing a one-time “transition” tax at reduced rates on these historic offshore earnings in exchange for removing the burden of additional income taxes on any future dividends received from foreign subsidiaries.

The Tax Act does appear to have had an effect on cash repatriation in 2018 and increased spending on domestic M&A transactions may have been driven, in part, by US companies that no longer have a federal income tax incentive to avoid the repatriation of cash. According to data from the US Bureau of Economic Analysis, repatriated earnings totaled about \$571 billion in the first three quarters of 2018, which is a 268% increase over the entirety of 2017. Although the data does not specify whether the repatriated amounts were previously untaxed earnings or current earnings, the year-over-year increase in repatriated earnings is dramatic.

“They are very capable, dedicated, available and knowledgeable.”

– Chambers & Partners USA, 2018

Tax Cuts and Domestic Incentives

The transition tax is notable in that it is imposed whether or not the previously untaxed earnings are repatriated. This would suggest that an increase in M&A activity, to the extent attributable to the Tax Act, may also be caused by other business-focused provisions of the legislation, including the reduction in the corporate tax rate to 21% and the availability of 100% bonus depreciation on many capital investments.

The lower corporate tax rate should continue to help reduce the cost of capital and lead to greater after-tax profit, increasing companies' cash balances, which may result in more M&A transactions. For the next five years, companies will also be allowed to deduct immediately 100% of the cost of certain depreciable tangible assets, including used assets acquired from third parties. Asset acquisitions therefore should become more valuable to buyers in the post-tax reform world. The reduction in the corporate income tax rate and benefits such as 100% bonus depreciation have been projected to raise domestic investment, even when accounting for offsetting provisions such as new limitations on business interest deductions.

Received 95% rating on the Human Rights Campaign's Corporate Equality Index, 2018

Looking Ahead

The factors underlying business activity in 2018 look poised to continue in 2019 and lead to a healthy and active M&A market. Access to capital should continue to drive M&A in 2019 as corporations and private equity firms plan for growth.

In one survey of C-suite leaders, many execs said they are seeing tax savings provided by tax reform that will influence their businesses. The anticipated uses of tax savings are diverse as respondents plan to use tax savings on growth initiatives, R&D, digital capabilities, cybersecurity, and M&A.

According to another accounting firm study, the top intended use of additional cash in 2019 is M&A. In addition, respondents generally expected to close more M&A deals in 2019 and many expected their deals to be larger than in 2018. Also notable is that respondents indicated that they're likely to make geographic changes in light of tax reform, perhaps suggesting that investments in administrative

offices, R&D centers, and manufacturing plants will be directed toward the US.

Overall, early indicators suggest that M&A activity will be strong in 2019, but that businesses will pursue a variety of investment paths as they seek to grow. Access to cash will help enable businesses to pursue their objectives, while certain provisions of the Tax Act may help push those businesses toward investments in the US.

A Material Adverse Effect Merger Termination in Delaware

By Steven Haas

The most significant M&A decision arising out of the Delaware courts in 2018 was *Akorn v. Fresenius Kabi AG*, C.A. No. 2018-0300-JTL (Del. Ch. Oct. 1, 2018), which held that a target corporation had suffered a "material adverse effect" allowing the buyer to terminate the merger agreement. Prior to this decision, no Delaware court had ever found a material adverse effect, or MAE, to have occurred. As such, *Akorn* provides a roadmap for future dealmakers and litigants going forward.

The *Akorn* case involved unusual circumstances involving, according to the court, "a dramatic, unexpected, and company-specific downturn in [the target's] business" and "whistleblower letters that made alarming allegations about data integrity issues at [the target]." Among other things, the court found that the target's EBITDA had declined by 86% over the year following the signing of the merger agreement. It also noted that analysts had estimated the target's standalone view between \$5.00 and \$12.00 per share compared to an estimated value around \$32.00 per share when the target entered into the merger agreement. In addition, the court estimated that remediating the target's regulatory failures would take several years and cost \$900 million, which was equal to approximately 21% of the implied merger price. The court held that these adverse developments constituted an MAE.

The court also found that the target had breached its representations relating to regulatory compliance in a manner that had a material adverse effect on the target's business. This constituted a second, independent basis on which the buyer could refuse to consummate the merger.

Named by *Corporate Board Member* magazine as one of “America’s Best Corporate Law Firms”

Finally, the court found the target had breached its covenant to use commercially reasonable efforts to carry on its business in all material respects in the ordinary course of business. The court said the target “chose consciously to depart from the ordinary course of business that a generic pharmaceutical company would follow” and that its actions “departed from what [the buyer] would reasonably expect and changed the calculus of the acquisition for purposes of closing.”

In the author’s opinion, *Akorn* is an important case, but does not significantly change Delaware’s “MAE” jurisprudence. The court found that the material adverse effect was “durationally significant” and showed “no sign of abating.” The court also found that the adverse changes were specific to the target rather than attributable to an industry decline. The regulatory violations were also of a very serious nature, requiring significant cost and time to remediate. The court contrasted prior MAE cases as follows:

[T]he difference between this case and its forbearers is that the remorse was justified. In both *IBP* and *Hexion*, the buyers had second thoughts because of problems with their own businesses spurred by broader economic factors. In this case, by contrast, [the buyer] responded after [the target] suffered a General MAE and after a legitimate investigation uncovered pervasive regulatory compliance failures.

Thus, *Akorn* provides an important roadmap for future litigants, but a material adverse effect still remains a significant hurdle for buyers to overcome.

The Culture of Counterparties

By Roger Griesmeyer

Increasingly, we hear many of the same comments and concerns from private equity (and other) clients pursuing acquisitions. There are record amounts of “dry powder” chasing common targets and industries. Auction processes continue to be intensely competitive and, often, the winner presented a bid quite similar to others. Conversely, we also read about acquisitions that either failed to close or closed and only later revealed significant issues. Now, more than ever, the scope of due diligence must be expanded, and, indeed, even the approach to a target must be modified by private equity funds and other acquirers to include the significant consideration of the target’s culture. Clients are increasingly requesting creative advice and solutions in order to gain a competitive advantage in such situations.

For thematic continuity and the sake of brevity, we will break this discussion into macro and micro cultural considerations in both approach and due diligence from the perspective of a private equity acquirer. However, these concepts and principles can be applied to almost any transaction and party.

Culture and the Approach

Common sense, experience, and basic psychology provide most seasoned private equity dealmakers with the tools to gain at least some small advantages in approaching a potential acquisition target. Humans are predisposed to like people to whom they are similar. Acquirers that emphasize actual or perceived similarities between themselves and decision makers at targets invariably find more long-term success in the competitive deal landscape.

The importance of cultural insight and understanding cannot be overstated. From a macro perspective, your deal team must first understand the cultural norms and traditions of the target’s locale. On a micro level, a deeper understanding of the target-specific culture and the unique perspective of its decision makers is imperative.

Macro Culture

The most effective deal teams take the time to study a target's macro culture and expectations. A tired, but true, platitude is that you get many second chances, but only one chance to make a first impression. When doing business in a foreign country, learn the proper, formal, and customary business greeting in the relevant language with proper pronunciation. While your counterpart may often speak English, there is no substitute for the sense of familiarity language can bring. Simply being able to say hello, thank you, and goodbye in the proper form and context will almost invariably elicit a warm smile and engender a sense of perceived similarity from counterparts.

Similarly, research more subtle, but important, cultural standards for business. For example, consider norms for business attire for in-person meetings. Outward signs of prosperity may be a crucial signal in some environments, while understated, thoughtful sartorial choices are more respected in others. Learn about typical body language and movement; is measured, articulate stillness a cultural sign of confidence and authority, or does the relevant culture celebrate (and reward) passion and interest with increased gesticulation and specific body positioning? Are there indicia of interest or dissatisfaction that vary from our own culture, such as leaning forward or backward or crossing arms or legs? Like in a good game of poker, a fund's target will observe all cues and interactions to glean information about the acquirer's intentions, abilities, and fit.

Even domestic targets' macro cultures can and will vary by location. While the deal team may not need to learn a greeting in a foreign language, the tone and pace of one's speech can be modulated to breed a sense of familiarity and similarity. Be prepared to use common idioms and expressions that may be unique to the relevant locale. Slow down (or speed up) speech patterns to better match locals. Considerations of applicable dress codes and body language apply equally in domestic situations to those described above in foreign acquisitions.

Deal teams already understand and incorporate much of the foregoing. However, there is a wealth of resources to aid in and supplement the implementation of these concepts. Many private equity funds have long understood the tremendous benefits of cultural diversity in their workforce. When approaching a new target culture, the first, and often best, resource is an employee or consultant with deep familiarity with such culture. Actively seek such persons and their advice on each of the foregoing issues. Invite them to

speak to the deal team about business decorum and their unique experiences and, if appropriate, incorporate them into the deal team.

Micro Culture

The foregoing notwithstanding, each target company inevitably has its own micro culture to which to adapt. Many of the same tools and skills will serve a deal team well, but significant and thoughtful observation and adaptation are required to gain an edge in a competitive acquisition process.

By necessity, the first interactions with a potential target will most often be with ownership or management. Most of us reflexively visit LinkedIn or similar resources to learn more about such people and identify resume-level details. Similarities in experience (or concepts found in posts) can be used to facilitate a warm introduction. But dive further into any clues about such people that can be found online. Books, articles, or other content written by or about these parties can provide valuable insight about a variety of topics. Observe writing style and common patterns or phrases, as well as similarities in publicly available photos. Seek out speeches and interviews, if any, and marketing materials describing such people. Leaders are often sought after for their commentary and observations on their industries, trends, challenges, successes, and failures. They also have one or more favorite stories highlighting particularly impactful moments in their careers or lives. The seasoned deal team seeks common ground with these experiences and a way to elicit similarity to their own intentions and vision for the target.

As the initial approach progresses, whether through one or more meetings, phone calls, or emails, vigilant observation and adaptation should continue. Note whether the target's principals are more formal or relaxed, direct or indirect in their communications. Consider the patterns and structure of emails, as well as the timing and content. Discern preferred cues from the way in which the target parties interact with you and with each other: Is speech measured and slower or gregarious and speedy? Do the parties interrupt each other without consequence or pause for one or more beats after the speaker is clearly finished? Are emails terse or lengthy, and is there a consistent grammar or style between the target's primary points of communication?

The sense of familiarity and similarity between the acquirer's deal team and the target's principals can deepen as minor adjustments are made in communication style. Rather, micro adaptations to the target's unique cultural norms can

increase the opportunity for success, as well as elicit useful additional insights and information that may not otherwise be shared between the parties.

Culture and Due Diligence

Many cultures and industries have established standards for due diligence, and the wise deal team avails itself of the same. From the initial request to financial investigation to meetings with key customers and employees, the needs of the acquirer for information necessary to make an investment decision must be balanced against an understanding of the most familiar macro and micro processes of the target culture.

Macro Culture

Here, again, consistently successful dealmakers seek out all available resources for insight into the due diligence process. In some cultures, due diligence is commonly understood to be an arduous, invasive affair that continues unabated until the eve of execution of the purchase agreement. For others, efficiency, specificity, and speed are the expected norms. While we all tout our ability to move swiftly to execution, the expectations and realities can vary greatly.

In an auction process, virtual data rooms and management meetings usually comprise the bulk of the initial due diligence. In a specific approach, a request list or similar exchange of information will be required. In either case, take care to understand the larger perception of your organization and the expectations of the target as the process unfolds. Requests for diligence items should be set forth in a familiar form more common to the target's culture and practices. If certain information is less commonly requested in the target's culture, take a moment to discuss the request and the reasoning for it in advance with the target's principals or advisors. Simply sending a standard form in an email without context can create persistent mistrust in advance of useful negotiations. Relatedly, additional requests for information should be previewed and presented in light of relevant concerns.

Also, take care to understand more mundane business practices. Some cultures require requests to be made and discussions to be had between persons of similar standing within their respective organizations. Certain topics may be considered inappropriate for discussion above or below a level of seniority. While rarely fatal, errors with respect to such matters can aggregate to an implicit bias among target decision makers regarding the acquirer's ability to understand

the target's culture, market, and business and, ultimately, close a desirable deal.

Embracing and preparing for differences in common financial practices is another consideration. As a baseline matter, be familiar with common accounting treatments in the target's culture, especially relevant variations from US GAAP. Understand the format in which financial information is likely to be presented, and be ready to present additional inquiries and feedback in a similar format. Likewise, take a moment to review the standard formatting and content of indications of interest, term sheets, letters of intent, and the like. Are the concepts of escrows, earn-outs, or carve-outs, to name a few, anathema or unfamiliar to the target's culture? While these may be critical deal points that must be addressed, consider repackaging such concepts to be more palatable to the recipient. To the extent practicable, adjust your typical templates to incorporate culturally relevant terms, conditions, and stylistic elements.

Micro Culture

Ultimately, most final transaction decisions will come down to the specific target and its people. And this is where acquirers have the greatest opportunity during the diligence process to increase their odds of success. Each of the foregoing efforts and tools can now be utilized to maximum effect to win the deal or avoid a costly mistake.

Observe how employees at all levels behave and interact. Is information shared or compartmentalized? Are the tones of emails and conversations generally upbeat, reserved, argumentative, or harried? Is the workforce diverse (in all respects, at all levels)? How are employees treated by supervisors and those they manage?

There are myriad ways to obtain this information with varying effect and efficacy. You may consider it advantageous to employ or consult with industrial organizational psychologists to better assess employee morale and identify potential improvements, as well as red flags. Read key employee reviews, when possible, both as reviewers and reviewees, to gain insight into management style, expectations, and strategies. Consider the impact and integration of such employees in your portfolio. Even more simple, read (with a grain of salt, of course) anonymous employee reviews and discussions about the target on websites such as GlassDoor and Reddit. One dissatisfied employee may not be significant, but a pattern or theme of consistent praise, behavior, or complaints may reveal insights (good and bad) of which even the target may not be generally aware.

Throughout the diligence process, measure the quality, accuracy, and speed of the materials produced. Pay particular attention to consistently delayed or problematic disclosures and the areas and people from which such materials originate. Depending upon the subject matter, this may be inconsequential or extremely significant to the acquirer's comfort level (and negotiation strategy) at the purchase agreement stage, as well as with respect to future plans for the target.

Conclusion

More than ever, our private equity clients demand that we, as their counsel, understand their company, business, industry, and people in order to grow our relationship. In short, we must understand our clients' culture. Similarly, clients seeking to successfully acquire target companies in a competitive deal market must understand the targets' macro and micro cultures, especially when entering a new geographical region, industry, or relationship. In order to achieve these objectives, acquirers (and their representatives) must be resourceful, creative, and vigilant in observing and adapting to the target's culture.

Select Design Considerations When Structuring Change-in-Control Pay

By Anthony Eppert

The purpose of this article is to discuss select design considerations when structuring change-in-control bonus arrangements for key employees.

Identify the Key Employees

The first step is to identify which key employees should participate and at what approximate values. The focus should be on those key employees who have an ability to increase shareholder value. To that end, questions to ask include:

- Do any of the key employees have the ability to increase the value of the target company if he or she remained employed through or after consummation of the transaction?
- If contingent consideration is part of the purchase price (e.g., earn-outs to shareholders), will any of the key employees who remain with the buyer after the transaction have the ability to increase the value of such

contingent consideration, and if yes, do we want to incentivize them to maximize, for example, the earn-out to selling shareholders?

Funding Trigger

What type of transaction should trigger a payout? Sounds simple enough, but this issue requires thought because these types of compensatory arrangements are often effectuated at a time when the seller has not yet started the sale process or when a buyer has not yet been identified, and as a result, the seller is not certain what type of sale transaction will occur.

For example, should a sale of 50% or more of the company's total voting power trigger funding (i.e., the answer is typically yes)? If the answer is yes, then a design point to consider is what happens to the remaining compensatory interest if, for example, only 70% of the company is sold. The following example highlights the issue:

Target and Employee Mary entered into an arrangement where 5% of change-in-control proceeds will be paid to Employee Mary. Eventually the company is sold, but only 70% of the company is sold with the selling shareholders continuing to hold the remaining 30%. Upon consummation of such change-in-control, does Mary still receive 5% as though 100% of the company were sold? Or is her 5% interest reduced pro rata, and paid out upon consummation of the change-in-control with no remaining interest owed to her (i.e., after payout, she has no claim to the remaining 30% that is continued to be owned by the shareholders)? Or does Employee Mary continue to own a 5% interest in the remaining 30%?

The funding trigger should also address whether a monetization of the company's intellectual property rights should trigger a payout if such monetization results in payouts to the company's shareholders (i.e., the company licenses its IP, becomes a royalty company, and never has a change-in-control transaction).

Consider Creating a Pool

Change-in-control bonus arrangements are often designed when all of the participating key employees have not yet been identified. How can the compensatory arrangement be designed when not all of the participating employees are known?

This situation can be resolved by creating a pool of dollars denominated as a fixed dollar amount or percentage of the sale proceeds. A benefit of a pool concept is that it can be denominated in units, thus creating a self-contained pool

that can be diluted as key employees are later identified to participate in the pool. An example of a basic pool formula is: [(pool value/total number of units issued and outstanding immediately prior to consummation of the sale transaction) x number of units awarded to the key employee]. The following is an example of a more advanced unit concept where the pool is a percentage of the sale proceeds:

Key Employee’s Interest = [{A-(B+C) x D}/E] x F

A =	The value (as determined by the Board) of all cash and noncash proceeds that are paid to the company or its shareholders in the sale transaction.
B =	Any and all company-related debt or liability that continues (or will continue) to be held by one or more shareholders of the company immediately after the sale transaction.
C =	All Costs associated with the sale transaction (e.g., accountant fees, attorney fees, investment banker fees, etc.), as such costs are reasonably determined by the Board.
D =	The intended pool size, set forth as a percentage of the above equation.
E =	The total number of Units granted under the plan that remain issued and outstanding (i.e., were not previously forfeited) as of immediately prior to the sale transaction.
F =	The number of Units held by the Key Employee.

Determining Sale Proceeds

Another important consideration is determining whether the value of the award (or the value of the pool) should fluctuate based upon the value of the sale transaction proceeds. You should also consider whether the value of the award (or the value of the pool) should be linked only to the sale proceeds that the selling shareholders receive, or instead, whether such value should also include contingent consideration, such as earn-outs received by the selling shareholders.

Vesting Conditions

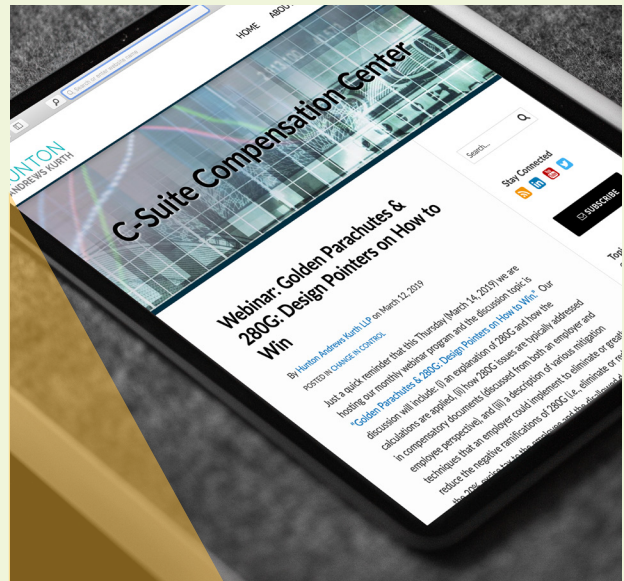
The most common vesting condition is the requirement that the key employee remain employed by the company and in good standing on the payment date. And in situations where vesting is intended to occur after the sale transaction, then it is common to incorporate accelerated vesting if the key employee’s employment with the buyer is terminated by the key employee for good reason or by the buyer without cause.

Our multidisciplinary executive compensation and employee benefits practice members are thought leaders in the design and implementation of change-in-control bonus arrangements and stand ready to assist our clients who may be thinking about implementing such an arrangement, or who may want a review of existing arrangements.

C-Suite Compensation Center

csuitecompensationcenter.com

Compensation issues of today and tomorrow are increasingly complex due to evolving laws, changing administrative rules and increasing shareholder activity. It is clear that faulty navigation through this changing landscape can lead to liability. A primary step to avoiding liability is to hire competent advisors. The members of our Compensation Practice Group are multi-disciplinary within the various substantive areas of compensation. As multi-disciplinary practitioners, we take a holistic and full-service approach to compensation matters that considers all substantive areas of compensation.



“The team is experienced, resourceful, and has deep practical insight and strategic acumen.”

– Chambers & Partners USA, 2018

Preserving Insurance Assets Post-Merger

By: Michael Levine and Geoffrey Fehling

The preservation of insurance assets continues to be an important and often overlooked consideration in the world of corporate transactions and restructurings. Corporate policyholders pay tens—if not hundreds—of thousands of dollars in premiums yet often neglect to take the steps necessary to ensure that those insurance assets remain available to successor and restructured entities.

The significant impact that a corporate policyholder's actions can have on the survivability of insurance assets following a merger, acquisition, or other transaction is well illustrated by the New Jersey federal court's decision in *BCB Bancorp, Inc. v. Progressive Casualty Insurance*, No. CV 13-1261, 2017 WL 4155235 (D.N.J. Sept. 18, 2017). In *BCB Bancorp*, the court granted summary judgment for a surviving bank asserting coverage rights under a D&O policy issued to an entity that dissolved in a statutory merger. The court based its decision, in part, on the wording of the parties' merger agreement, which structured the transaction in accordance with the New Jersey Business Corporation Act.

The *BCB Bancorp* court refused to permit the insurer to deny coverage for post-merger defense costs incurred in connection with a pre-merger shareholder class action lawsuit, rejecting the carrier's argument that the insurer's duty to defend the original policyholder's officers and directors extinguished when the policyholder dissolved and merged into the surviving entity. The court stated that “[u]nder the NJBCA, the surviving corporation of a merger in essence steps into the shoes of the merged entity for the purposes of the merged entity's rights and liabilities,” including with respect to the merged entity's insurance policies. Accordingly, the court held that “an insurance contract must contain specific exclusionary language to prevent a transfer of rights to the surviving entity under the NJBCA.” No such exclusion existed in the policy, so the transfer of assets in the merger preserved the surviving entity's insurance rights.

The intersection of M&A deals and insurance remained a timely topic through 2018. For example, the final draft of the Restatement of Law on Liability Insurance, approved by the American Law Institute in May 2018, discusses at length the acceptable methods to assign rights under a liability policy and the potential pitfalls if proper steps are not taken, including specific discussions on assigning liability insurance rights in mergers and acquisitions and preserving coverage for pre-merger or acquisition liabilities. This area of law should remain active in 2019 and beyond.

The availability of insurance rights to a surviving entity is inherently fact-specific and largely depends on the facts of the underlying claim, the policy language, the structure of the underlying transaction under applicable state law, and, as was the case in *BCB Bancorp*, any applicable state statutes that address the transfer of insurance assets in corporate transactions. M&A deals like the one at issue in *BCB Bancorp* highlight the potential insurance pitfalls that can occur in a merger that are not always addressed by statute or by typical safeguards such as so-called “change in control” provisions or specific insurance asset transfer provisions in the transaction documents. Questions to consider include:

- What types and amounts of insurance are at issue?
- In addition to its own insurance, is the merging entity an additional insured under the insurance of others (e.g., parent, subsidiary, or partner entities) and does it consider that coverage to be an asset material to the transaction?
- What kind of wrongful acts, entities, losses, and time periods are impacted by a change in control?
- Do insurance policies differentiate between different kinds of transactions, such as “inside” transactions resulting in surviving entities that may retain the same characteristics as the old company?
- Is “tail” or run-off coverage available or appropriate to address any possible coverage gaps?
- Have the transactional lawyers considered insurance issues at all stages of the deal process?
- Have the parties considered representations and warranties insurance, which can provide protection for both buyers and sellers for breaches of representations and warranties in M&A transactions?

As with any insurance question, advanced planning and a complete understanding of the interrelation of the company's various insurance assets are critical to ensuring a smooth transition of those assets to the surviving entity. Consultation with experienced coverage counsel early in the deal process can assist the deal team by ensuring appropriate structures are in place and that all proper notifications have been made. Adding such insurance planning to the team's due diligence checklist can help the team to maximize insurance assets and mitigate the risk of uncovered claims following the transaction.

Nearly 40% of our top clients date back more than 25 years

California Consumer Privacy Act and Its Impact on M&A Transactions

By Lisa Sotto, Aaron Simpson, and Brittany Bacon

In June 2018, California enacted a new consumer privacy law that signals a significant shift in US privacy regulation and imposes first-of-its-kind data protection requirements on businesses that have California consumers and employees. The California Consumer Privacy Act of 2018 (CCPA), which was signed into law on June 28, 2018, requires covered businesses to provide increased transparency on how they collect and share personal information of California residents and establishes new privacy rights for Californians, such as access and deletion rights and the ability to opt out of the sale of their data. Due to these new rights and obligations, the CCPA likely will require significant changes to many US businesses' data collection and sharing practices to honor California residents' privacy rights under the new law.

California's new privacy law warrants careful consideration in the context of M&A transactions. When conducting due diligence, it is imperative to evaluate the CCPA's effect on a target company's business and to assess key compliance risks associated with the new law.

Key components of the CCPA include:

- **Access Right.** Upon a verifiable request from a consumer, a covered business must disclose (1) the categories and specific pieces of personal information the business has collected about that consumer; (2) the categories of sources from which the personal information is collected; (3) the business or commercial purposes for collecting or selling personal information; and (4) the categories of third parties with whom the business shares personal information. A covered business that sells a consumer's personal information or discloses it for a business purpose must also provide the consumer specific information about the company's data-sharing practices in response to a verifiable access request.

- **Deletion Right.** Subject to several enumerated exceptions, the CCPA will require a business, upon verifiable request from a consumer, to delete personal information about the consumer which the business has collected from the consumer and direct any service providers to delete the consumer's personal information.
- **Opt-Out Right.** Covered businesses must provide a clear and conspicuous link on their website that says "Do Not Sell My Personal Information" and provide consumers a mechanism to opt out of the sale of their personal information, a decision which the covered business must respect. The CCPA broadly defines sale as "selling, renting, releasing, disclosing, disseminating, making available, transferring, or otherwise communicating orally, in writing, or by electronic or other means, a consumer's personal information by the covered business to another business or a third party for monetary or other valuable consideration." Importantly, the law provides certain exceptions for mergers, acquisitions, and other types of corporate transactions provided that specific conditions are met. If the merger or acquisition, however, materially alters the way personal information of a consumer is used or shared such that it is "materially inconsistent with the promises made at the time of collection," consumers will need to be provided sufficiently prominent and robust prior notice of the new or changed practice that enables consumers to easily exercise their right to opt out.
- **Transparency.** The CCPA will require certain disclosures in a covered business's online privacy policies, including a description of consumers' rights under the CCPA (e.g., the right to opt out of the sale of their personal information). Covered businesses must also disclose certain data practices from the preceding 12 months about (i) the categories of personal information collected about consumers; (ii) the categories of sources from which the personal information is collected; (iii) the business or commercial purpose for collecting or selling personal information; and (iv) the categories of third parties with whom the business shares personal information. If the covered business sells consumers' personal information or discloses it to third parties for a business purpose, the notice must also include lists of the categories of personal information sold or disclosed about consumers in the preceding 12 months.



- **Specific Rules for Minors.** If a covered business has actual knowledge that a consumer is less than 16 years of age, the CCPA prohibits the business from selling that consumer’s personal information unless (1) the consumer is between 13–16 years of age and has affirmatively authorized the sale (i.e., they have opted in); or (2) the consumer is less than 13 years of age and the consumer’s parent or guardian has affirmatively authorized the sale.
- **Non-Discrimination and Financial Incentives.** Covered businesses cannot discriminate against consumers for exercising any of their rights under the CCPA. Covered businesses can, however, offer financial incentives for the collection, sale, or deletion of personal information.
- **Enforcement.** The CCPA is enforceable by the California Attorney General (AG) and authorizes a civil penalty up to \$2,500 for each violation or \$7,500 for each intentional violation. The CCPA also provides a private right of action only in connection with certain “unauthorized access and exfiltration, theft, or disclosure” of a consumer’s nonencrypted or nonredacted personal information, as defined in the state’s breach notification law, if the business failed “to implement and maintain reasonable security procedures and practices appropriate to the nature of the information to protect the personal information.” The consumer may bring an action to recover damages up to \$750 per incident or actual damages, whichever is greater.

“They foster a very welcoming environment, they are very practical and they are very responsive to client requests.”

– Chambers & Partners USA, 2018

On September 23, 2018, California’s governor signed a bill that delays the AG’s enforcement of the CCPA until six months after publication of the AG’s implementing regulations, or July 1, 2020, whichever comes first. By performing due diligence on a target company’s CCPA compliance in advance of a potential transaction, businesses can effectively identify and manage key compliance issues associated with the target’s failure to honor California residents’ new privacy rights. Depending on the nature and scope of the target’s business, these compliance risks ultimately may impact the relevant deal from an investment, reputational, or operational perspective.

For more information on the CCPA and a variety of other data privacy and cybersecurity topics, please visit Hunton Andrews Kurth’s Privacy & Information Security Law Blog at huntonprivacyblog.com.

Privacy & Information Security Law Blog

huntonprivacyblog.com

Our Privacy & Information Security Law blog focuses on global privacy and cybersecurity legal issues. This award-winning and top-ranked blog features current information and legal commentary on a broad range of related topics in the news, including the latest cybersecurity events, updates with respect to the EU General Data Protection Regulation, legislative activities and enforcement actions, EU-US Privacy Shield and other privacy issues.



2018 Energy Highlights



MPLX LP

Representation of Conflicts Committee
Acquisition of general partner interest and
IDRs held by Marathon Petroleum Corp.

Value \$18.2 billion



Antero Midstream GP LP

Representation of Conflicts Committee
Acquisition of Antero Midstream Partners
LP from public unitholders and Antero
Resources

Value \$7.2 billion



InfraREIT, Inc.

Represented Special Committee
Sale of publicly-traded electricity
transmission company to Oncor Electric
Delivery Company LLC

Value \$2.215 billion



EQT GP Holdings LP

Representation of Conflicts Committee
Acquisition of IDRs held by Rice
Midstream Partners

Value \$937 million



Morgan Stanley Infrastructure

Acquisition of Bayonne Energy Center
from Macquarie Infrastructure
Corporation

Value \$900 million



Electricity Generating Public Company Limited of Thailand

Representation of an affiliate
Cross-border acquisition of 40%
ownership interest in Paju Energy Service
Company Limited and LNG-fired power
station in South Korea

Value \$796.4 million



Beal Bank USA

Sale of two combined cycle power
blocks representing over 1,000 MW of
the aggregate generating capacity of
the Gila River Power Station in Arizona

Value \$330 million



Sabine Oil & Gas Corp.

Sale of 35% working interest in oil
and gas properties in Haynesville
Shale formation to subsidiary of
Osaka Gas Co., Ltd.

Value \$146 million



Framatome, Inc.

Acquisition of the nuclear automation
assets of Schneider Electric Industries
USA, Inc.

Value confidential

2018 Financial Services Highlights



Spirit of Texas Bancshares, Inc.

Spirit of Texas Bancshares, Inc.

Acquisition of First Beeville
Financial Corporation
Value \$63.7 million

Acquisition of Comanche
National Corporation
Value \$52.9 million



InBankshares, Corp.

Acquisition of Raton Capital Corporation

Value \$46.3 million



Westbound Bank

Sale to Guaranty Bancshares, Inc.

Value \$43.1 million



Brown Advisory

Acquisition of Signature Family
Wealth Advisors

Value confidential



Commerce National Financial Services, Inc.

Sale to Amarillo National Bancorp. Inc.

Value confidential



Renovo Capital

Global Radar Holdings, LLC
Acquisition of Prime Time Research, Inc.
Acquisition of easyBackgrounds, Inc.

Values confidential



Bolsas y Mercados Españoles

Creation of a joint venture entity
between Bolsas y Mercados Españoles
and Bolsa Mexicana de Valores

Value \$6 million



Finance of America Mortgage LLC

Acquisition of assets of American Equity
Mortgage, Inc.
Acquisition of assets of Skyline
Financial Corp.

Values confidential



Medley Capital Corp.

Sale of OmniVere LLC to Driven, Inc.

Value confidential

2018 Manufacturing Highlights



Carlisle Companies Incorporated

Sale of Carlisle FoodService Products to the Jordan Company L.P.

Value \$750 million



Carlisle Companies Incorporated

Acquisition of Petersen Aluminum Corporation

Value \$197 million



Dana Incorporated

Acquisition of Drive Systems Segment of OC Oerlikon Corporation AG, Pfäffikon

Value approx. \$600 million



Dana Incorporated

Acquisition of a majority stake in electric motor and related component manufacturer TM4 Inc.

Value \$127 million



Axalta Coating Systems LLC

Acquisition of the paint color matching software and services business of YADA Systems, Inc.

Value confidential



Huntington Ingalls Industries, Inc.

Acquisition of G2, Inc., a cybersecurity solutions and services company.

Value confidential



Sucro Sourcing

Sucro Sourcing

Advising majority shareholder in the recapitalization of Sucro Can Sourcing through the financing and acquisition of certain minority interests

Value \$42 million

2018 Retail/Consumer Products Highlights



Altria

Altria Group Inc.

Financing for acquisition of Minority Interest in JUUL Labs, Inc.

Value \$12.8 billion



Altria

Altria Group Inc.

Financing for acquisition of Minority Interest in Cronos Group Inc.

Value \$1.8 billion

Smithfield

Good food. Responsibly.®

Smithfield Foods

Creation of Align Renewable Natural Gas, a joint venture with Dominion Energy

Value \$145 million



Stop&Shop®

The Stop & Shop Supermarket Company LLC

Acquisition of King Kullen Grocery Co., Inc.

Value confidential



Markel Ventures, Inc.

Acquisition of Brahmin Leather Works, Inc., a leader in fashion leather handbags.

Value confidential



Sabra Dipping Company, LLC

Sale of Salsa Business to Pacifica Foods, LLC

Value confidential



Checkers Drive-in Restaurants, Inc.

Sales of company-owned restaurants to franchisees and strategic acquisitions of franchise locations

Value confidential

2018 Highlights from Other Industries



Pebblebrook Hotel Trust

Acquisition of publicly-traded REIT, LaSalle Hotel Properties

Value \$5.2 billion



Chenega Corporation

Acquisition of Venturi, an aerospace engineering company, from its founder Michael J. Alvarez and certain employee shareholders

Value confidential

Health System Client

Acquisition of two acute care hospitals, joint venture acquisition of inpatient rehabilitation hospital and over 20 outpatient rehab clinics, acquisition of HMO, acquisition of large multi-specialty physician practice, contribution of acute care hospital to joint venture and sale of acute care hospital



Jobson Medical Information Holdings, LLC

Sale to WebMD Health Corp.

Value confidential



Bregal Sagemount

Discovery Data, Inc.
Acquisition of Financial Media Group LLC
Leveraged Recapitalization
Repurchase of Preferred Shares

Values confidential



Bregal Sagemount

Sale of Discovery Data, Inc.
To Northlane Capital Partners LLC

Value confidential



iTeachTexas, L.L.C.

Sale to The Learners Edge, LLC, a company providing continuing education and professional development for teachers

Value confidential



Asendia USA, Inc.

Acquisition of Globegistics, Inc., a provider of Global eCommerce and mail solutions

Value confidential

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