# M&A | Reporter

**2018**

HUNTON
ANDREWS KURTH

## DEAR CLIENTS AND FRIENDS,

We are pleased to present to our clients and friends the *Hunton Andrews Kurth 2018 M&A Reporter.* While the strategic business objectives that drive major corporate transactions may vary, the need for experienced, effective legal counsel remains constant. Our mergers and acquisitions practice helps senior business leadership negotiate the increasingly complex M&A path, from initial consideration and negotiation of a deal, through due diligence and regulatory approvals, to completion of the project and post-closing integration. In the pages that follow, you will see that our M&A team had a very active and successful 2017, thanks to the innovation and creativity of our clients.

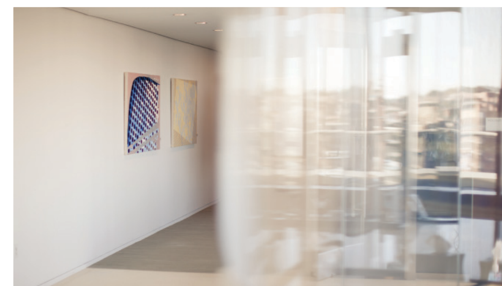
We are also excited about the completion of our own merger. On April 2, Hunton & Williams LLP and Andrews Kurth Kenyon LLP merged to become Hunton Andrews Kurth LLP. The merger creates a 1,000 lawyer firm that ranks as one of the top 50 legal practices by headcount and anticipated combined revenue. While the 2018 M&A Reporter primarily highlights our pre-merger activity, our combined M&A practice will continue to partner with our clients on successful and innovative transactions.

Despite challenges in 2017 M&A activity in the United States, generally, we had a very strong showing on Thomson Reuters' M&A league tables. Prior to our merger, we ranked among the top 15 US law firms across three M&A categories and among the top 30 firms worldwide in deals announced in full-year 2017, including ranking #13 for US Target Announced Deals.

Our strong M&A performance is a testament to the firm's broad-based transactional platform, industry strength, and, most importantly, loyal clients. We appreciate the confidence our clients place in us to assist in a wide range of interesting and challenging transactions and engagements.

In the pages that follow, we are pleased to share some highlights of our work during 2017, as well as our insight into future market trends and forecasting. We look forward to another exciting year and thank you again for your continued confidence in the work we do together.

Wally Martinez
Managing Partner



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# 2018 M&A FORECAST

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At the beginning of 2017, dealmakers seemed to be holding their breaths. US M&A volume, for example, dropped by more than half from the fourth quarter of 2016 to the first quarter of 2017. Although M&A transaction volume picked up as the year progressed, and the overall number of US transactions increased by about 14%, aggregate US transaction volume ultimately decreased approximately 16% from 2016. Many of the headwinds that affected 2017 appear to have been resolved, which we believe could result in a resurgent M&A market in 2018.

## Looking Back on 2017

One key reason for the slow start in 2017 was political uncertainty, particularly in the aftermath of the close US presidential election in November 2016. Markets and dealmakers were unsure how to evaluate the implications of President Trump's election, and the possibility of wide-ranging policy changes seemed high. In particular, market participants' hope for business-friendly proposals like deregulation and lower corporate tax rates clashed with their concern over border taxes, tariffs, and other restrictions on free trade.

In hindsight, however, President Trump's policy decisions had limited effects on the M&A market in 2017. The Trump administration succeeded in lowering the corporate tax rate and generally refrained from adopting new border taxes, tariffs, and other restrictions on trade. Furthermore, although the administration oversaw numerous deregulatory actions, there was no sweeping deregulation of industries that might have driven an increase in M&A. In January 2018, however, President Trump did impose new tariffs on solar panels and washing machines. It remains to be seen whether these tariffs were isolated acts or the start of a larger protectionist trend.

In addition to the uncertainty created by the recent tariffs, the Trump administration's stance on multilateral trade deals remains in flux. One of President Trump's first major executive actions was to abandon the Trans-Pacific Partnership, which had the potential to expand free trade in many industries between the United States and many Asian countries. In his recent keynote speech at the World Economic Forum in Davos, however, President Trump suggested

that the United States might join the trade deal after all. Closer to home, the Trump administration continues to threaten to withdraw from NAFTA if the treaty is not renegotiated in favor of the United States. The United States, Mexico, and Canada trade goods worth more than $1 trillion annually, and whether NAFTA is terminated, modified, or left unchanged could have a dramatic effect on the US and North American economy.

Based in part on the steady, generally business-friendly policies advanced by the Trump administration thus far, US equity markets enjoyed what can only be described as a stellar 2017. The S&P 500 advanced over 19%, finishing the year within 1% of its all-time high set earlier in December, and, in a historical first, the S&P 500 did not record a single down calendar month during the year. This was in stark contrast to Wall Street's consensus forecast of a 5.5% return, which was the lowest estimated return since at least 2005.

## Economic Environment in 2018

Looking forward, the economic environment appears to be generally supportive of a rebound in the M&A market. The Federal Reserve, after raising its federal funds rate target a quarter point in December from 1%–1.25% to 1.25%–1.5%, forecast three quarter-point rate increases in 2018 and two quarter-point rate increases in each of 2019 and 2020. The Federal Reserve also raised its US economic growth forecast to 2.5% (up from 2.1% in September) and predicted inflation would not reach its 2% target until 2019. Continued low interest rates, combined with steady but not overwhelming economic growth and low inflation, should help create a favorable economic environment for M&A activity. The economic outlook may change, of course, but for now it seems more likely that any hesitation by dealmakers to engage in M&A transactions will be attributable to individual idiosyncrasies rather than market-wide anxiety.

## Available Cash and Changing Demographics

At the end of the third quarter of 2017, the Federal Reserve estimated that liquid assets of US non-financial companies reached a record $2.4 trillion. Private equity funds had a similarly large amount of investable assets, estimated by one observer to be approximately $960 billion in July 2017. Sooner or later, these assets must be deployed. And although companies may invest their cash in something other than M&A, private equity funds are, in most cases, forced buyers. This dynamic may result in rising acquisition valuations, particularly for high-quality companies that use an effective sale process to generate demand from multiple potential buyers.

Complementing these piles of available cash is the country's changing demographic mix. The Baby Boomers, generally considered those born between 1946 and 1964, are now between 53 and 72 years old. Among these approximately 76 million people are a large number of business owners and, at some point, the desire to retire will cause these aging business owners to put their companies up for sale. This may help explain the rise in the number of transactions in 2017 even as aggregate transaction volume decreased.

We note also that the number of private equity-backed US companies continues to increase. This could be a cause or result of an IPO market that generally remains soft, but it seems likely that many businesses will continue to be sold privately rather than offered to the public. We expect private equity funds to be particularly sensitive to how the changes to the tax code may affect their after-tax returns, but it remains unclear whether the new tax regime will drive a wave of selling, buying, or restructuring, or if mixed incentives will not result in a one-way shift in private equity fund behavior.

## Tax Cuts and Jobs Act

On December 22, 2017, President Trump signed into law the largest change to the tax code since its overhaul

under President Reagan in 1986. The implications of the Tax Cuts and Jobs Act (the "Act") are numerous and still uncertain, but a few key points merit mentioning here:

- Lower Corporate Tax Rate: The corporate federal income tax rate was lowered to a flat rate of 21% from a maximum rate of 35%. Greater after-tax profits will increase companies' cash balances, which may result in more M&A transactions.

- Elimination of Future Repatriation Taxes: The Act abandons the current worldwide international tax system for a new territorial tax system. Companies will pay a one-time tax (at a reduced rate) on historic earnings of foreign subsidiaries, but generally will not owe any tax on future dividends received from foreign subsidiaries. US companies will no longer have an incentive to avoid repatriating cash, and some companies, most notably Apple, ExxonMobil, and Honeywell, have already announced plans to repatriate cash currently held overseas. This influx of cash may increase spending on domestic M&A transactions by large, multinational companies.

- Asset Acquisitions Become More Valuable to Buyers: For the next five years, companies will be allowed to deduct immediately 100% of the cost of certain depreciable tangible assets, now including assets acquired from a third party. Asset acquisitions, including deemed asset acquisitions (e.g., through appropriate elections or by purchasing a disregarded entity), therefore will become more valuable to buyers.

- Cap on Deductibility of Interest Expense: Deductions for net business interest expense are now capped at 30% of an amount roughly equivalent to EBITDA. Beginning in 2022, such deductions will be capped at 30% of an amount that approximates EBIT. This change generally will not affect strategic acquirers, but we may see fewer debt-financed acquisitions. This change also may result in lower after-tax returns for highly leveraged acquisitions by private equity companies.

- Limitations on NOLs: The Act eliminates the two-year net operating loss ("NOL") carryback and limits the NOL carryforward to 80% of taxable income for losses arising in taxable years beginning after December 31, 2017. Due to these limitations, buyers may view a target company's NOLs as less important going forward.

- Increased Use of C Corporations: Because the corporate federal income tax rate was lowered to a flat 21% rate, there is a reduced tax rate differential between C corporations and flow-through entities. Although the Act provides a deduction of up to 20% for non-corporate taxpayers for "qualified business income" earned through certain flow-through entities, this deduction is phased out (and, in circumstances, does not apply) for taxpayers above certain income thresholds. We may see fewer conversions to flow-through treatment, particularly when the qualified business income deduction would be limited or inapplicable.

### Technology Company M&A

In recent years, the number of M&A transactions involving technology companies has increased significantly. Some of these transactions involve technology companies' expanding their product portfolio or entering into new sectors of the economy. Many other transactions, however, have resulted from companies in traditionally less technology-focused sectors trying to incorporate new technologies into their existing business models. This has been particularly pronounced in the retail and fintech

industries, where there has been a significant race to identify and implement disruptive technologies. In 2017, for example, Amazon acquired Whole Foods to add a physical footprint to its strong online presence. This followed Walmart's 2016 acquisition of Jet.com, which seemed to be an attempt to compete more directly with Amazon online. It will become increasingly difficult to draw meaningful distinctions between "tech" and "non-tech" companies, and we expect the trend of overlap between sectors—including through cross-sector M&A—to continue in 2018.

In addition to headline-grabbing acquisitions, however, many companies are using M&A to address gaps in their existing business models. Some companies may choose to address such gaps by hiring new talent to develop the missing technology internally. But in many cases, acquiring an existing company with a viable, proof-of-concept technology may be a cheaper and more efficient solution than developing the technology from scratch. Along similar lines, an increasing number of companies are turning to "corporate venture capital" to fund startups relevant to their business models. Examples of technologies that have and will continue to be adopted by "traditional" businesses include, among others:

- Blockchain: Although cryptocurrencies like bitcoin dominate the news today, the underlying blockchain technology can be adapted to record and process transactions, verify documents, manage supply chains, and track inventory, among a myriad of other uses.
- Artificial Intelligence: Through the continued advancement of various types of artificial intelligence, computers are now being used in fields ranging from medical diagnostics to self-driving cars to virtual assistants.
- Big Data: The capture, organization, storage, and analysis of the vast amount of information now generated by customer-business interactions can increase efficiency and generate new opportunities for many types of businesses.
- "Internet of Things": The growing network of physical devices embedded with sensors, software, and network connectivity will continue to expand into new types of consumer devices.

### Chinese Outbound Acquisitions and CFIUS Reform

Another persistent trend over the last several years has been outbound Chinese acquisitions. In 2005, Chinese companies spent less than $10 billion on foreign companies. That amount tripled by 2009 and rose to over $140 billion in 2017, placing China second behind the United States in total outbound acquisition volume.

The continuation of this trend may be at risk, however, as in August the Chinese government imposed new capital controls that caused outbound acquisitions to drop significantly. These capital controls, aimed at reducing "irrational" investments in certain industries and assets, separate potential investments into three classes:

- Banned: military, gaming, and certain other unsavory industries;
- Restricted: real estate and hotels, film and entertainment, sports, and investments that do not meet environmental standards; and
- Encouraged: investments that improve China's technology, advance the Belt and Road initiative to strengthen connections between China and the rest of Asia, and expand research and development capabilities and investments in the oil, mining, agriculture, and fishing industries.

In addition to the above China-imposed restrictions, Chinese acquisitions of US companies appear likely to draw greater scrutiny from the Committee on Foreign

Investment in the United States ("CFIUS") going forward. CFIUS reviews certain covered transactions involving Chinese and other foreign buyers of US companies and assets, but China has ranked first in the number of transactions reviewed each year since 2011. In November, a bipartisan group of senators and US representatives introduced the Foreign Investment Risk Review Modernization Act ("FIRRMA").

FIRRMA would result in, among other things, closer scrutiny of transactions involving buyers from certain countries of "special concern," which would no doubt include China. The bill would also expand the types of transactions subject to CFIUS review, as well as increase the number of factors CFIUS would consider when evaluating whether a transaction presents a national security risk. Generally speaking, the changes would result in a broader focus on information, and potential informational and cybersecurity vulnerabilities, rather than physical assets alone.

Even setting the possible enactment of FIRRMA aside, however, the CFIUS review process has resulted in the termination of three proposed acquisitions involving Chinese buyers since December 2016. Note that this does not include potential transactions for which a CFIUS filing was withdrawn and not refiled. Withdrawal typically occurs when CFIUS indicates to the parties that it will not approve a transaction, but in that event the failed transaction generally does not become public knowledge. More recently, President Trump issued an executive order on CFIUS' recommendation prohibiting Broadcom's takeover bid for chipmaker Qualcomm. The order cited credible evidence of national security concerns. CFIUS had previously cited concerns that the acquisition could weaken US influence over 5G standardization and disrupt defense technology contracts. The action was especially notable because Broadcom is Singapore-based, and had announced plans to redomicile in the United States.

Whether these developments have a significant impact on the overall US M&A market remains to be seen, but sellers considering transactions with Chinese and other foreign buyers must stay abreast of these developments.

## Conclusion

After a slow start and a mixed year overall in 2017, we believe that reduced political uncertainty and the continuation of current economic trends, combined with the other factors discussed above, will result in a more favorable environment for M&A in 2018. We expect that dealmakers, particularly on the buy-side, who were generally wary heading into 2017 will turn a more optimistic outlook into a resurgent year in the M&A market.

## Ranked #13 for 2017 US Target Announced Deals in Thomson Reuters' M&A League Tables

# RETAIL AND CONSUMER PRODUCTS

## OVERVIEW AND TRENDS IN RETAIL AND CONSUMER PRODUCTS M&A

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**Candace Moss**
*Associate, Mergers & Acquisitions, Washington*

US consumer markets total deal value in 2017 was up 109% and deal volume was up 12% over 2016, according to PwC. The food and beverage subsector accounted for 19% of consumer markets deal value for the year, and announced food and beverage M&A deal value was up 37% from 2016. Also, restaurant M&A outperformed previous levels, with deals such as Darden Restaurants, Inc.'s $780 million purchase of Cheddar's Scratch Kitchen. Corporate acquisitions of restaurants totaled around $11.7 billion as of November 2017 compared to an average of $2 billion per year since 2008. Private equity firms more than tripled the amount spent on restaurant acquisitions, with an increase from $1.4 billion in 2016 to $4.5 billion in 2017.

### Preview of 2018

Looking ahead to 2018, retail and consumer products M&A activity is predicted to remain at the same level or increase, due to a variety of factors. More companies may look to strategic transactions in 2018 to better position themselves in an increasingly competitive market. Recent examples include Amazon's acquisition of Whole Foods, Panera's acquisition of Au Bon Pain, and Arby's acquisition of Buffalo Wild Wings. We also expect more brick-and-mortar retailers will seek to expand their online presence through acquisitions, such as Walmart's acquisition of Jet.com and PetSmart's acquisition of Chewy.com. In the retail industry, underperformance in several subsectors may lead to more M&A intended to quickly spur growth and financial results. A Deloitte survey of corporate executives and private equity investors noted that respondents expect more deals between retailers and technology companies, with an increasing convergence between those two industries as retail sales continue moving to online channels. Companies and private equity firms still have significant cash reserves, which they are likely to use for M&A; interest rates are still relatively low for those seeking access to capital; and record high stock market levels can provide increased purchasing power for financing acquisitions. Additionally, given the current political climate, companies may anticipate benefits from deregulation and a more advantageous business environment due to tax reform. Notwithstanding these factors, M&A activity could be negatively impacted in the event of unfavorable regulatory changes, increased antitrust scrutiny of transactions under the merger review process, or changes to trade policies such as NAFTA.

## 2017 RETAIL AND CONSUMER PRODUCTS INDUSTRY M&A HIGHLIGHTS

**Sample retail and consumer products industry representations include:**

- We represented Darden Restaurants, Inc. (NYSE: DRI), in its $780 million purchase of Cheddar's Scratch Kitchen, a casual value dining leader with 165 company-owned and franchised locations nationwide, from its private equity owners. Also in connection with the transaction, we represented Darden in its $500 million senior notes offering that funded a portion of the purchase price.

  Darden is a restaurant company featuring a portfolio of differentiated brands that include Olive Garden, LongHorn Steakhouse, Cheddar's Scratch Kitchen, Yard House, The Capital Grille, Seasons 52, Bahama Breeze and Eddie V's. Darden employs more than 175,000 team members in over 1,700 restaurants, creating memorable experiences for 380 million guests each year in communities across North America.

  Our M&A team for the transaction was led by **Gary Thompson** and **Steven Haas**, and also included **Cameron Hill**, **Charles Brewer**, **Jay Ritter**, **John Gary Maynard**, **J.C. Chenault**, **Robert Dumbacher**, **Richard Warren**, **Jeffry Blair**, and **Caitlin Sawyer**.

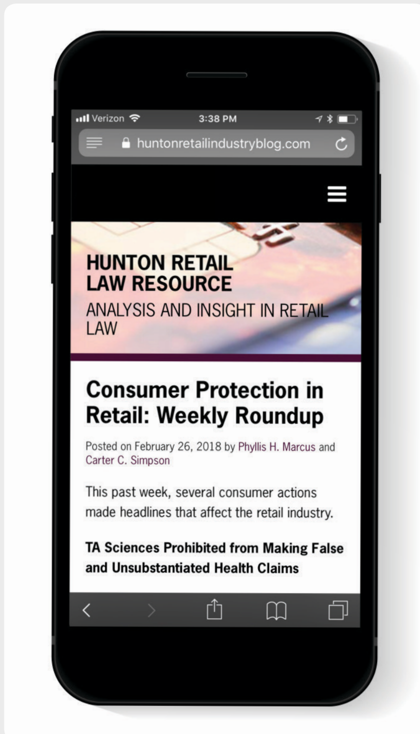
- We represented Lowe's Companies, Inc. (NYSE: LOW), in its acquisition of Maintenance Supply Headquarters, a leading distributor of maintenance, repair, and operations ("MRO") products serving the multifamily housing industry, for $512 million. Houston-based Maintenance Supply Headquarters operates 13 distribution centers serving customers in 29 geographic areas, mainly in the western, southeastern, and south-central United States. The acquisition is a significant step in Lowe's strategy to deepen its relationship with pro customers. The deal was named the USA Corporate Deal of the Year by the Atlas M&A Awards and the Corporate/Strategic Deal of the Year by The M&A Advisor. Our team was led by **Steve Patterson**, **Richard Warren**, and **Candace Moss**.

**"Once again, the team at Hunton was an invaluable part of our acquisition deal team. The firm is recognized not just within the Law Department but also by Darden's executive leadership as providing practical, solution-oriented counsel in an efficient and cost-effective manner. We couldn't be more pleased with the way the transaction was handled from start to finish."**

– Tony Morrow, Darden's Senior Vice President, Division General Counsel

- We continued to assist Smithfield Foods, Inc. with its strategic M&A program, building on over 20 transactional representations since 2001.
  - We represented Smithfield in the buy-out of its 50% joint venture partner in Kansas City Sausage Company, LLC, the leading US pre-rigor sausage producer and processor. Kansas City Sausage produces some of Smithfield's fastest-growing products, including Smithfield Breakfast Sausage, Smithfield Craft Collection Seasonal Brats, and Carando Meatballs, the fastest-selling fresh meatball in the United States. Our M&A team for the transaction was led by **Richard Warren**.
  - We also represented Smithfield in a Series B investment in Chef'd, a best-in-class e-commerce meal marketplace, making Smithfield the largest strategic investor in the company. Chef'd offers customers the opportunity to choose and reorder from more than a thousand meal options, without subscriptions or membership fees. **Wyatt Deal** led our team for the transaction

    Smithfield is a $15 billion global food company, committed to providing good food in a responsible way. The company is the world's largest pork processor and hog producer, and is the leader in numerous packaged meats categories in the U.S.




## HUNTON RETAIL LAW RESOURCE BLOG

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## 2017 M&A YEAR IN REVIEW FOR BANK MERGERS

**Heather Archer Eastep**
*Partner, Financial Institutions Corporate and Regulatory, Washington*

2017 was an improved year for bank M&A activity. Both the number of transactions and the median book value multiple per transaction were higher than in 2016. 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.

### Transaction Drivers

Buyers sought merger partners with attractive core deposits to offset increasing loan to deposit ratios throughout the industry, as well as targets that offered substantial cost savings to purchasers. On the sell-side, the continued cost of compliance with regulation and supervisory guidance, struggles with net interest margins, and a competitive lending environment drove transactions.

Many transactions were strategic combinations, often allowing buyers to move into new, desirable geographic markets or approach key regulatory thresholds, such as swiftly moving past the $10 billion mark. These strategic transactions were often negotiated deals in which buyers engaged selling institutions that were not actively shopping themselves, which is a shift over prior years' transactions.

Bank IPOs increased in 2017, with 19 offerings as compared to 8 in 2016. We anticipate the uptick in IPOs will continue, which means more public company banks executing on the expansion strategies that led investors to participate in their IPOs. Selling institutions have also been willing to take not only public company stock as transaction currency, but also private bank stock—effectively allowing their shareholders to benefit from the synergistic value of the transaction and favorable market conditions in a rising rate environment.

Shareholder activism continues to contribute to bank sales. In 2017, several of the transactions we participated in were driven by bank investors that advocated for M&A transactions to effect their exit strategies and take advantage of higher pricing in the market. Another driver for selling institutions was management succession for institutions that were unable to attract new talent or effect their strategic plan.

### Tax Cuts and Jobs Act

In late 2017, President Trump delivered on his tax reform initiative, which has increased optimism over deals in 2018. Pricing had already increased in January 2018, presumably speculating on the tax savings. SNL reported that the first two weeks in January 2018 saw eight deals announced, with a median deal value-to-tangible common equity ratio of 210.4%. This was compared to seven deals announced over the same period in 2017 with a median deal value-to-tangible common equity ratio of 158.6%.

Interestingly, the Tax Cuts and Jobs Act may also increase premiums for Subchapter S banks that are contemplating

selling. In 2017, we saw a scarcity premium because of the dwindling number of community banks in certain geographically attractive markets, and we may see a tax premium develop in 2018 as well. As many Subchapter S banks contemplate converting to C corporations, a tax premium may develop given the favorable tax treatment in certain transaction structures to acquire Subchapter S banking targets.

Bank M&A transactions in 2017 were geographically concentrated, with active areas including Texas and the Southeast. These are also markets favored by the recent tax act due to their lower state income tax rates and home values. We anticipate that the M&A activity in those markets will continue to accelerate in 2018.

**Regulatory Relief**

Lastly, regulatory relief—or lack thereof—continued to play a role in bank M&A transactions in 2017. In October 2017, the Federal Reserve and Conference of State Bank Supervisors released their survey of *Community Banking in the 21st Century*, which described an increased regulatory burden as a driver to consolidation. Roughly half of the bankers surveyed said that regulatory costs played a "very important" role as they considered offers to sell. More than 11% of the bankers surveyed had "received and seriously considered" an offer from a potential acquirer in the last year.

Trump's nominees to head the federal banking agencies began stepping into their roles in late 2017 and will continue to do so in early 2018. Each has had a stated goal to reduce the regulatory burden on community banks. There is also possible legislative relief for community banks recently passing the House Financial Services Committee. However, the impact of regulatory relief on improving efficiency at community banks and reducing the compliance burden will take time for bankers to digest and implement before reaping cost savings and thus should not significantly slow bank M&A activity in 2018. In addition, certain aspects of regulatory relief may actually increase bank M&A activity. If the small bank holding company threshold is increased to $3 billion, more M&A activity may occur between smaller institutions that can remain under that level on a combined basis.

**"Hunton has advised Xenith since its inception and has been a trusted and valued partner through every step of our journey."**

– Gaylon Layfield, CEO, Xenith Bankshares

## 2017 FINANCIAL SERVICES INDUSTRY M&A HIGHLIGHTS

**Sample financial services industry representations include:**

- We advised global banking institution Banco de Sabadell, S.A. (SAB: BME), and its US subsidiary Sabadell United Bank, a national banking association, in Sabadell United Bank's $1.025 billion acquisition by IBERIABANK Corporation (NASDAQ: IBKC) in a stock and cash transaction. Miami-based **Fernando Alonso** and **Uriel Mendieta** led our team, which has a longstanding relationship with Banco de Sabadell, S.A., and supported the growth of its US subsidiary, Sabadell United Bank, throughout the years.
- We represented Bank of the Cascades and its parent company, Cascade Bancorp (NASDAQ: CACB), in their sale to First Interstate BancSystem, Inc. (NASDAQ: FIBK). The merger created a combined banking institution with approximately $12.1 billion in total assets and a unique banking franchise that extends from Idaho to Oregon. The merger builds on Cascades' previous expansion through its acquisition of Home Federal Bancorp, Inc., as well as through its purchase of 15 Bank of America branch locations in Oregon and Washington. Our team was led by **Peter Weinstock**, head of our financial institutions practice, and **Steven Haas**, co-head of our M&A practice.
- Longtime client Xenith Bankshares Inc. (NASDAQ: XBKS) joined forces with Union Bankshares Corp. (NASDAQ: UBSH) in an all-stock deal valued at over $700 million, forming the preeminent community banking franchise in Virginia. The combined company has total assets of about $12.3 billion, total deposits of $9.5 billion, gross loans of $9.3 billion, and the fourth-largest branch network in Virginia.  Our team was led by **Brian Hager** and **Heather Archer**.

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

## BATTERY STORAGE – WELL ON ITS WAY

**Gregory Lang**
*Partner, Energy and Infrastructure, New York*

Several of our clients have noted that the battery storage industry in 2018 has the feel of the solar power space at the turn of the century: the pricing is still too high in many cases for mass development and deployment, but the technology is only getting better, and cheaper. Time will tell if this comparison is warranted and battery storage development takes off as solar development did.

Many experts believe battery energy storage, coupled with other renewable generation technologies (such as solar or wind), has the long-term capability of displacing peaking plans, altering future transmission and distribution plans, and limiting the effect of the intermittency of renewables. If so, utilities should position themselves to fund or develop battery storage projects to manage peak loads more efficiently, regulate the frequency of the grid more cheaply, and spend less on transmission and distribution costs. Indeed, many utilities already have, as noted below. Some industry experts believe this development growth will be facilitated by the decreasing cost of battery storage, which is largely owing to the gains made in the last decade by electric vehicle development companies such as Tesla and long-term strategic players in the market such as General Electric, Siemens, and AES.

As with the build-out of solar, California is on the front line, with its 50% renewable energy target by 2050 and battery storage targets of 1,300 MW. Arizona is also active in this space, as the Arizona Corporation Commission proposed in February 2018 a clean energy overhaul that calls for an 80% clean energy target by 2050 and for 3,000 MW of energy storage procurement. New York has recently set goals for 50% renewable energy by 2050 with a storage target of 1,500 MW. And more and more utilities are including energy storage in their integrated resource plans. For example, Portland General Electric recently announced RFPs for up to 39 MW of battery storage, close to the upper limit of Oregon's energy mandate—whereas utilities often target the lower limit for renewable projects as the power has historically been priced at a premium to traditional fossil fuel-powered options. Meanwhile, according to Navigant Research, the aggregate capacity of hybrid battery storage projects (i.e., storage projects using two or more energy storage technologies) in the United States is projected to grow from 78.6 MW in 2017 to 2.1 GW in 2026, which includes behind-the-meter projects and utility-scale hybrid projects.

So, why is battery storage poised to take off? The main reason is that with the build-out of intermittent solar and wind, there is a greater and greater need to keep the grid stable and reliable during peak hours. Because batteries can both store and release power, they are extremely well suited for this task. The other significant reason is the decreasing cost of batteries. Ultimately, battery storage projects will need to access more revenue streams to optimize their value, such as pure generation services, ancillary services, transmission and distribution support, and customer management services. But for now, as noted above, most larger- or grid-scale projects rely on just one of these streams, most commonly ancillary services, and most ancillary

service contracts are not long enough in duration to justify decent returns (at least not yet). If longer contracts become economically viable (or are given any regulatory assistance), battery storage will become more economic and suitable for financing.

To take advantage of some of these opportunities, utilities will have to adjust to include more battery storage optionality as energy storage shaves peaks, flattens the load curve, and starts to compete against existing peaking facilities.  This is happening already. For example, in January 2018, the California Public Utilities Commission ("CPUC") authorized Pacific Gas & Electric to initiate a process to procure energy storage or preferred resources (such as demand response or distributed solar assets) to ensure local reliability of the grid in areas previously served by gas plants. The CPUC did qualify the directive, requiring the resources to be available by 2019 "if feasible and at a reasonable cost to ratepayers," so there is some wiggle room. This appears, however, to be one of the first times a utility will purchase energy storage to replace existing gas plants for local capacity purposes and a harbinger that battery storage is a growing competitor of certain fossil-fueled peaking facilities.

As a further sign of energy storage's growing importance, Fluence Energy LLC, a joint venture between Siemens and AES, recently announced a new solar-dispatchable platform, SunFlex Energy Storage, that aims to capture and store excess solar energy. The platform will supply the 100 MW lithium-ion battery-based Alamitos storage project in Long Beach, California, to serve Southern California Edison's service territory in western Los Angeles. Fluence Energy is also developing storage projects for San Diego Gas & Electric and Arizona Public Service.

The energy storage industry is clearly maturing.  We are committed to the electric generation and storage space and stand ready to grow with this burgeoning market.

**Sample energy storage representations include:**

- Represented a tax equity investor in its acquisition of an interest in an ITC-eligible 2 MW solar PV/10 MW battery energy storage system in Arizona.
- Represented a technology and financial services company in aquiring an interest in a joint venture formed to own, develop, construct, and operate a 20 MW battery energy storage project in California.
- Represented a tax equity investor in connection with a partnership with a residential solar developer on a portfolio of residential solar projects that include battery storage systems.
- Represented a strategic investor in connection with the sale of a division with battery storage and fuel cell storage capabilities.

## 2017 ENERGY INDUSTRY M&A HIGHLIGHTS

**Sample energy industry representations include:**

- We represented Energy Absolute Public Company Limited (BKK: EA) in its acquisition of an up to 35.20% equity interest in Amita Technologies Inc., the leading lithium-ion polymer battery manufacturer in Taiwan. Amita produces energy storage batteries, which can be used in electric vehicles, data center UPS units, and the renewable energy industry. The acquisition is pivotal to EA's business expansion strategy of using energy storage systems for its solar and wind farms. Our team was led by **Edward Koehler**, **Chumbhot Plangtrakul**, and **Peerasanti Somritutai**.
- We represented Banpu Infinergy Company Limited, a one-stop provider of solar energy solutions and a subsidiary of Banpu Public Company Limited (BKK: BANPU), in its approximately $55.7 million investment in convertible preference shares in the Sunseap Group, the largest clean-energy solutions provider of roof-top solar projects in Singapore

**“They consistently delivered sound, practical legal advice to me and the Framatome business team. I look forward to our continuing relationship and would not hesitate to recommend my Hunton team to others looking for counsel.”** – David Royer, General Counsel, Framatome

with solar ground-mount and roof-top pipeline projects and energy storage solutions underway in Australia, Cambodia, India, Malaysia, Thailand, and Vietnam. Our team included **Edward Koehler**, **James Bradley**, **Chumbhot Plangtrakul**, **Bradley Alexander**, **Peter Bang**, **Christopher Huong**, and **Peerasanti Somritutai**.

- We represented Electricity Generating Public Company Limited (BKK: EGCO) in the divestment of its 49% equity stake held by its wholly-owned subsidiary Gen Plus B.V. in Masin-AES Pte. Ltd. (“MAPL”) to SMC Global Power Holdings Corp. (“SMC”), for $850 million. AES Phil Investment Pte. Ltd. owned the remaining 51% interest in MAPL and fully divested its equity interest in MAPL to SMC in a concurrent sale. The total enterprise value of the transaction is $2.4 billion, which has been reported as one of the largest deals in the Philippines’ corporate history. Our team was led by **Edward Koehler**, **Chumbhot Plangtrakul**, and **Christopher Huong**.

- On January 18, 2018, Framatome Inc. announced its entry into definitive agreements with Schneider Electric to acquire Schneider Electric’s nuclear automation business. The acquisition by Framatome, which is expected to close before the end of the first quarter of 2018, will expand Framatome’s instrumentation and control offerings worldwide. These I&C systems are the central nervous system of a nuclear power plant, allowing operators to control reactor operations. In addition to drafting the acquisition documents, the Hunton team assisted with the development and negotiation of long-term manufacturing and distribution relationships between Framatome and Schneider Electric. Our team was led by **Michael McCann** and included, among others, **Richard Massony** on corporate matters, **Amanda Wait** and **Andrew Eklund** on competition matters, and **Manuel Maisog** on issues related to operations and employees in China.

- We represented Great Plains Energy Incorporated (NYSE: GXP), a public utility holding company headquartered in Kansas City, Missouri, on an SEC-registered notes offering of $4.3 billion. The proceeds from the offering were intended to be used to fund the cash consideration payable in connection with Great Plains’ proposed acquisition of Westar Energy, Inc., the largest electric utility provider in Kansas. When local utility regulators failed to approve the terms of the merger in April 2017, Great Plains unwound the $4.3 billion of acquisition debt pursuant to a special optional redemption provision. Our team was led by **Pete O’Brien**, **Christina Kwon** and **Andrew Spector**.

## CONTINGENT CONSIDERATION IN MORTGAGE M&A

**Michael McCann**
*Partner, Mergers & Acquisitions, Richmond*

**Michael Goldman**
*Partner, Mergers & Acquisitions, Richmond*

**Austin Maloney**
*Associate, Mergers & Acquisitions, Richmond*

With approximately 35 announced transactions, 2017 was an active year for mortgage industry M&A. Several factors point to continued consolidation in 2018 particularly on the origination side of the industry, including rising interest rates, declining volumes, increased regulatory and compliance costs, and generally an abundance of smaller origination companies looking to exit while larger, acquisitive companies seek volume, scale, and growth opportunities through acquisition. Throughout 2017 and thus far into 2018, we have noticed a rise in the use of creative contingent purchase price mechanisms, specifically earn-outs, in origination-related transaction. The use of earn-outs, as well as other contingent or deferred consideration structures, is often necessary to bridge a divide on valuation between a buyer and a seller, particularly in situations where the seller is a family business or closely held entity. Uncertainty in valuations and market direction also tend to lead parties to consider some contingent or deferred consideration component to total purchase price.

Numerous factors play into the formation of contingent consideration provisions, but both sellers and buyers have reasons to consider including one of these provisions in their negotiations. Sellers with an optimistic outlook on the market (or on their company's ability to outperform others) are willing to "bet" on themselves in exchange for a piece of the upside potential. Buyers who may be either less optimistic in the market or less certain about the differentiating factors of the target company to the market are willing to give up some of that upside to avoid overpaying upfront. Instead of parties who view the value of the target assets differently coming to an impasse, contingent consideration schemes provide the aforementioned "bridge" between the parties' differing views of value and can provide comfort to both parties that their financial stake in the transaction will be closely tied to the actual performance of the subject assets.

Recent mortgage industry transactions have proved particularly difficult to value at closing as few hard, revenue-producing assets (e.g., inventory, IT platform) are included in transactions, especially where loans held for sale or mortgage servicing rights are carved out of the transaction. Rather, a significant portion of deals are focused on acquiring high-producing loan originators, expanding into different sales channels (e.g., retail, wholesale, reverse), or expanding the acquiror's geographic footprint. The buyer in these transactions is largely buying future production that is not guaranteed; therefore, contingent consideration provisions provide a more definitive mechanism for valuing their actual future production. This effect is amplified if a significant component of the value in a transaction is derived from a few key individuals and their continued performance, as contingent consideration mechanisms that benefit these key individuals can provide the incentive for them to achieve the expected performance that may have driven initial interest in the transaction.

While the use of contingent consideration provisions has risen, there is no "one size fits all" approach for determining the structure or terms of a contingent consideration mechanism. We have seen earn-outs based on loan origination volume tied to certain loan originators or branches acquired. We have seen earn-outs based on the profitability of the branches or sales channels that comprise the acquired business. Some parties prefer to use detailed calculations with multiple thresholds in determining the consideration to be paid while other parties prefer simpler approaches. Both approaches present benefits and risks. A more detailed contingent consideration mechanism will generally involve more intense negotiation between the parties prior to the consummation of the transaction, but it can help minimize or avoid disputes relating to the post-closing contingent consideration determination. On the other hand, while a simple contingent consideration provision that outlines the methodology and parameters broadly, but is light on details, can lead to more peaceful negotiations, which may be a factor if preservation of the target's "culture" is an important deal consideration, any resulting ambiguity can result in more post-closing conflict, particularly if the target assets do not perform as well as either party had anticipated, a result which is often market driven over the short period of an earn-out.

Another major point of negotiation with regard to contingent or deferred consideration structures is the allocation of control over the business or individuals whose performance will dictate the amount of contingent consideration ultimately paid. Sellers often push for some level of control, either through management authority or through covenants in the transaction documents. At a minimum, sellers want access to information in real time to monitor the performance of the individuals or the business and to monitor the progress toward any earn-out or other contingent consideration payment. Buyers, of course, are wary to relinquish any control over how they run the business that they just acquired. Reaching some compromise on the control issue is often as important, and as difficult, as reaching agreement on the components and metrics for the earn-out itself.

Emotions are always high when it comes to valuation in an M&A transaction. Earn-outs and other contingent consideration mechanisms are no different. They are always heavily negotiated and intensely analyzed. These mechanisms are also often the subject of post-closing disputes and litigation between the parties. When transactions involving a contingent or deferred consideration component are near signing, parties will often acknowledge that both sides are "taking some risk" and "putting some trust" in their new partner. While this attitude is constructive and often necessary to get a deal executed, parties should clearly discuss and define the specifics of any contingent or deferred consideration mechanism prior to signing so as to allow for more streamlined and effective integration and operation once the deal is closed.

## 2017 REAL ESTATE INDUSTRY M&A HIGHLIGHTS

**Sample real estate industry M&A representations include:**

- We represented Markel Ventures, Inc., in its acquisition of a majority interest in Costa Farms. Headquartered in Miami, Florida, Costa Farms is a third-generation, family-owned business and the largest producer of ornamental plants in the world with over 4,000 acres globally and almost 5,000 employees. Markel Ventures, a wholly-owned subsidiary of Markel Corporation (NYSE: MKL), owns a diverse family of industry-leading companies across the manufacturing, consumer, business services, financial services, and health care sectors. Our team was led by **Brian Hager** and included **James Kennedy** and **Richard Massony**.
- During 2017, we represented several large private equity firms in various transactions involving the sale of numerous private real estate investment trusts for an aggregate sales price of well over $3 billion. The assets owned by the private REITs were primarily multifamily, office, and hotel properties. Many of the REIT sales in 2017 employed buyer-side representations and warranty insurance to reduce continuing liability exposure for the selling subsidiaries of our clients. Our deal teams were led by **Daryl Robertson**, with **Katie Hull**, **Patrick Quine**, and **Carly Mayer** on M&A aspects, and by **Benjamin Browder** and **Jeffrey Giese**, with **Lindsay Kirton**, on real estate matters.
- We advised Apollo Asia Sprint Holding Co. Ltd. as a lead investor in preferred shares issued by, and as lead lender in related senior loans made to, subsidiaries of Pace Development Corporation Public Company Limited (BKK: PACE). The preferred share issuances totaled 7.8 billion Thai baht (approximately $218.9 million) and the senior loans totaled 658 million Thai baht (approximately $18.5 million), with proceeds to be applied to construction and financing costs associated with Thailand's tallest building, the iconic MahaNakhon mixed-use real estate project, and other corporate purposes. Our team was led by **James Bradley**, **Edward Koehler**, and **Cary Tolley**.

**Handled 600+ M&A transactions worth approximately $200 billion in the past five years.**

## BACK TO THE FUTURE: ANTITRUST MERGER ENFORCEMENT IN THE TRUMP ADMINISTRATION

**Amanda Wait**
*Partner, Competition, Washington*

**Andrew Eklund**
*Associate, Competition, Washington*

Early indications from the Trump administration suggest a merger review environment that may be more favorable than we saw during the Obama administration years.

In 2008, then-candidate Barack Obama pledged to “reinvigorate” antitrust enforcement after perceived lax enforcement during the George W. Bush administration. As a result, from 2008 until 2016, antitrust merger investigations, on average, took longer and were more onerous, and more deals were challenged. For example, a merger that was subject to a Second Request was 12% more likely to be challenged under the Obama administration than under the prior Bush administration.

**Merger Challenges as a Percentage of Second Requests**

Source: Fed. Trade Comm’n & US Dep’t of Justice, Antitrust Division, Hart-Scott-Rodino Annual Reports, FY2001–FY2016, available at https://www.ftc.gov/policy/reports policy-reports/annual-competition-reports.

Thus far during the Trump administration, there have been few public pronouncements about this administration’s intended treatment of merger review by the two federal antitrust agencies—the Federal Trade Commission and the Antitrust Division of the US Department of Justice. However, key political appointments and recent merger enforcement decisions, including those in the retail and consumer products space, suggest that this administration may dial back some of the Obama administration’s “reinvigorated” merger enforcement.

The theme for the Trump administration’s antitrust appointments appears to be “Back to the Future.” Many of the selected individuals held leadership positions at the antitrust agencies during the Bush administration. For example, at the Antitrust Division, the recently confirmed assistant attorney general, Makan Delrahim, and four of his six deputies all served in key antitrust positions under President Bush. A few blocks down Pennsylvania Avenue at the FTC, President Trump nominated Joe Simons, who formerly served as the director of the Bureau of Competition at the FTC under President Bush, to be the next chairman. Several key staff positions have also been filled at both agencies by former enforcers from the Bush administration.

Current antitrust officials appear to signal a return to a more favorable merger review environment for retail

and consumer products deals. The president's nominee to chair the FTC has been a vocal critic of some of the analyses used by the Obama administration to block retail deals involving supermarkets and other retailers.

As a final note, both the FTC and the Antitrust Division are implementing changes to ensure that merger reviews are shorter and less expensive under this administration. In April 2017, the FTC issued a statement detailing process reforms under which the FTC would "streamline demands for information in investigations to eliminate unnecessary costs to companies and individuals who receive them." Similarly, a senior DOJ official stated that "[t]he Antitrust Division … wants to reverse the trend by increasing the speed and reducing the burden of merger reviews."

We expect these moves toward a more streamlined review process to continue.

## Named to the BTI "Client Service A-Team" for 16 years

# DISTRESSED TRANSACTIONS AND RESTRUCTURINGS 2017 RECAP AND 2018 OUTLOOK: RETAILERS TAKE CENTER STAGE

**J.R. Smith**
*Partner, Bankruptcy, Restructuring and Creditors' Rights, Richmond*

**Justin Paget**
*Associate, Bankruptcy, Restructuring and Creditors' Rights, Richmond*

2017 was an ideal environment for companies looking to restructure, and 2018 looks to continue the trend. Over the last year, the crest of energy-related restructuring gave way to the continued surge of retail-sector bankruptcies and out-of-court financial restructurings. High-profile Chapter 11 cases, such as Toys "R" Us, Gymboree, and Payless, headlined retail sector woes, and yet validated that the climate is right for distressed companies to commit to restructuring their debt and implementing new business strategies.

While not a new trend, the rise in retail-sector bankruptcies appeared to come to a head in 2017. Traditional brick-and-mortar retailers experienced increased pressure from industrywide shifts in consumer preferences towards their e-commerce rivals. Specialty retailers also struggled to maintain profitability, as mass merchants with the ability to withstand smaller margins took market share and forced retailers to cut prices to boost sales.

The spate of recent retail bankruptcy filings typically precipitated store closings. Gymboree, Rue21, Payless, Perfumania and Charming Charlie—to give a few examples of retail companies that filed Chapter 11 bankruptcy in 2017—all proceeded with a round of store closings shortly following their bankruptcy filings in an effort to downsize, shedding unprofitable stores, cutting costs, and reducing footprints. Here, bankruptcy offers unique tools for these companies to reject real estate leases, shift or sell excess FF&E and inventory, and negotiate concessions from vendors and landlords in anticipation of emerging from bankruptcy with a restructured and slimmed balance sheet and more profitable operations.

Retail store closings were not limited to companies that filed Chapter 11 in 2017. This past year saw announcements from mass merchants J.C. Penney, Sears Holding Corp., Macy's, and Bon-Ton of widespread store shutterings—more than 400 stores since 2016—leaving soaring vacancy rates at shopping malls across the country. The loss of anchor tenants, which historically drove traffic for other tenants, has left shopping mall owners looking elsewhere, such as entertainment and dining tenants, to fill the void. Three- to five-year commercial real estate mortgage terms will force shopping center owners to pivot quickly or risk covenant defaults or an inability to refinance economically when loans mature. Mixed-use residential/commercial and lifestyle-focused redeployment of ailing shopping mall space is trending high.

Despite the struggles in the retail industry, financing remained both available and affordable for distressed companies. With inflation in check and rates only slightly above historic lows, the Federal Reserve raised interest rates three times in 2017. Combined

with a steadily growing economy, financing both in and outside of Chapter 11 bankruptcy proved widely available in 2017 despite political uncertainty. Those conditions should continue to persist for the first two quarters of 2018, but the horizon is a little hazy. The Federal Reserve forecasts an additional three upward rate adjustments for 2018. And, although short-term rates have risen steadily, albeit slowly, over the last year, long-term rates remain stubbornly low, resulting in some predictions of a dreaded inverted yield curve developing in the latter part of 2018. Distressed companies could face challenging refinancing options in the third and fourth quarter of 2018.

In 2018, it is likely that retailers will again account for the majority of M&A activity among distressed companies. Oil and gas prices appear to have stabilized, relieving much of the pressure on exploration and production companies. Similarly, a bottoming of coal prices and some easing of environmental regulations and enforcement have helped coal companies endure in the short to intermediate term. Although the new administration was not successful in repealing and replacing the Affordable Care Act, much uncertainty persists in the health care, insurance, and pharmaceutical sectors. Barring some unforeseen shock to any of these sectors, the focus of distressed M&A should again revolve around retail and any collateral damage to the commercial real estate sector.

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

Consumer spending will certainly play a key role in 2018. This past calendar year saw significant improvements in consumer spending, which boosted the economy and favored distressed retailers. Many economists are looking for an even better year in 2018, in part fueled by the recent tax legislation. On the other hand, credit card default rates climbed in the fourth quarter of 2017 to their highest levels in nearly a year. Whether this is solely due to improved confidence and spending or the start of a disturbing trend is unknown.

Continued strong consumer spending will support the same conditions seen in 2017 for restructuring and distressed transactions in the retail space, while any material pullback could alter the landscape for those distressed retailers that have not yet commenced a restructuring or are in the midst of one.

Lawyers in our bankruptcy, restructuring, and creditors' rights practice represented debtors and creditors in many of the largest and most complex corporate restructurings over the past year, including the largest retail case filed in 2017.

**Sample bankruptcy, restructuring, and creditors' rights representations include:**

- We received the 2017 Restructuring Deal of the Year award from the M&A Advisor in recognition of our representation of the Official Committee of Unsecured Creditors in the Chapter 11 bankruptcy of O.W. Bunker Holding North America, Inc., and affiliates in the District of Connecticut. Before abruptly filing for bankruptcy after the discovery of a massive internal fraud, O.W. Bunker was one the largest international traders of bunker fuel, with operations in 29 countries. Led by **Peter S. Partee, Sr.** and **Michael P. Richman**, we were able to negotiate a complex Chapter 11 plan that elicited the full cooperation of the company's secured creditor and resolved multiple conflicts between bankruptcy and maritime principles and proceedings, resulting in substantial distributions to unsecured creditors.
- We represented J.P. Morgan Chase Bank, N.A. (NYSE: JPM), in its capacity as administrative and collateral agent, lead arranger, and post-petition lender to Toys "R" Us, Inc., and its affiliates in their Chapter 11 bankruptcy cases filed in the US Bankruptcy Court in Richmond, Virginia. We serve as co-counsel along with the law firm of Davis Polk & Wardwell LLP. Our team is led by **Tyler Brown** and **Justin Paget**. The Chapter 11 bankruptcy of Toys "R" Us was the largest retail filing of 2017 in the country.

- We represented Bank of America, N.A. (NYSE: BAC), in its capacity as pre-petition and post-petition lender to the Gymboree Corporation and its affiliates in their Chapter 11 bankruptcy cases filed in the US Bankruptcy Court in Richmond, Virginia. With critical financing in place, Gymboree successfully emerged from bankruptcy in September 2017 with a substantially improved financial position through the elimination of $900 million in debt from its balance sheet and a reduced store footprint. The company emerged with an $85 million new term loan and access to a $200 million revolving credit facility. Our team was led by **Tyler Brown** and **Justin Paget** and served as co-counsel to the bank along with the law firm of Morgan, Lewis & Bockius LLP.

- We represented the minority owners of Payless ShoeSource's 400-store Latin American business in their effort to protect this solvent and profitable business from the North American operations' insolvency. We also represented these minority owners in connection with their efforts to acquire Payless ShoeSource's majority interest in the Latin American business. After Payless ShoeSource placed the North America and China operations into Chapter 11 and announced its intention to retain and expand the Latin American business after restructuring, we assisted the minority owners in protecting the interests of the Latin American business against a threatened "renegotiation" of sourcing and intellectual property agreements with the North American parent by investigating and formulating potential objections to confirmation and litigation claims. As a result of our efforts, Payless ShoeSource abandoned its threat to "renegotiate" and modified the confirmed Chapter 11 plan. A multidisciplinary our team led by **Fernando Alonso**, **Kevin Eckhardt**, and **Matthew Bosher** represented the Latin American minority owners.

- We represented Secure Natural Resources, the owner of rare earth mineral rights at the Mountain Pass Mine in California that filed Chapter 11 with $1.7 billion in debt, in connection with a lease of the mineral rights and the Section 363 sale by Molycorp Minerals of the related surface rights at the mine. As a result of the lease and sale process, the mineral rights and surface rights were reunited in a single entity that has committed to quickly restarting production at the mine in compliance with environmental standards. A multidisciplinary team led by **Fernando Alonso**, **Peter Partee**, and **Kevin Eckhardt** helped achieve this result.

## BUSINESSES ARE INVESTING IN BLOCKCHAIN'S POTENTIAL

**Scott Kimpel**
*Partner, Capital Markets, Washington*

**Mayme Donohue**
*Associate, Capital Markets, Richmond*

In 2017, major companies accelerated their efforts to purchase or invest in blockchain startups and build internal blockchain-based solutions for their businesses. Despite continued regulatory uncertainty and market volatility around digital tokens and cryptocurrencies, industry giants are signaling their belief in blockchain's transformative impact through deliberate investment in the technology.

### Understanding Blockchain

Blockchain is a distributed ledger shared in real time across a peer-to-peer network that tracks the flow of assets and creates a shared and trusted record of transactions within the network. Transactions are verified using cryptographic equations and are recorded and timestamped in "blocks" of data. Each new block is "chained" to the previous blocks, resulting in the blockchain, which is shared among all participants simultaneously. The real-time distribution of the cryptographically secured ledger makes the record immutable and protects the system from fraudulent transactions. Only transactions that agree with the distributed ledger's current allocation of assets will be settled by the system, and the distributed ledger will only be updated with transactions that successfully settle. Notably, the distribution of the record across the network of participants eliminates the need for a central intermediary to settle transactions, increasing efficiency and speed of settlement while also reducing costs.

Blockchains exist in computer code and may be public or private and built to the specifications of the task they are designed to achieve. Bitcoin runs on a public, permissionless blockchain, meaning anyone can transact in bitcoin at his or her own discretion. Many of the business enterprise blockchain applications are permissioned blockchains that only allow authorized parties to participate in the system. This distinction is not unlike the difference between a company's public internet website and its internal, private intranet site only available to company personnel.

Leading financial institutions took early notice of blockchain's disruptive potential and have been racing to own the blockchain solutions that stand to replace many of their current fee-generating services. However, blockchain's impact is broader than finance and is already being tested in a variety of applications including supply chain management, food and product safety, customer loyalty and rewards programs, identity authentication, electronic health records, and real property title registry.

### M&A and Venture Capital Activity

Acquisitions of blockchain startups continued in 2017 and momentum is already growing in 2018. Among the most notable blockchain acquisitions in 2017 was Spotify's purchase of Mediachain Labs, a blockchain service designed to provide payments to owners of online media based on consumption. Additionally, Daimler Financial Services bought PayCash Europe to allow car-based mobile payments on blockchain. KPMG International acquired Matchi, a platform that connects financial institutions with cutting-edge fintech solutions like blockchain.

The year 2017 also saw major companies using their respective venture capital arms to invest in blockchain startups with potential solutions for their businesses.

For example, the venture arms of Verizon, Intel, and JetBlue invested in Filament, a company focused on facilitating the "Internet of Things" by creating hardware and software designed to allow machines and devices to interact with and transact on blockchain. Jaguar Land Rover's venture capital arm invested in DOVU, a company building a blockchain to enable and incentivize networked sharing of transportation data.

M&A and investment activity by companies seeking to utilize blockchain technology has already begun to pick up in 2018 as companies become more aware of its value.  Gil Beyda, the managing director of Comcast Ventures, has said publicly that his team will be "doubling down on blockchain" in 2018 with an "aggressive" investment strategy. Comcast Ventures is already invested in blockchain companies including MState, an accelerator for enterprise blockchain startups that also connects its startups with Fortune 500 companies interested in implementing blockchain solutions. As growing corporate investment continues to fund the development of blockchain startups, large companies will seek to acquire the blockchain startups that emerge as leaders and separate from the pack.

**Regulation of ICOs & Cryptocurrency**

With $6.5 billion invested in initial coin offerings ("ICOs") in 2017 and over $1.5 billion already invested so far in 2018, token sales are not slowing down despite an uncertain regulatory landscape. ICOs are a fundraising technique in which companies sell digital tokens typically in exchange for cryptocurrency. Initially unregulated by US federal and state agencies, in August of 2017 the Securities and Exchange Commission ("SEC") issued a report clarifying its view that digital tokens, depending on their characteristics, may be investment contracts and therefore securities.

The SEC has since brought several enforcement actions against promoters of ICOs for the unregistered offering of securities. Without a valid exemption from registration, both the issuer and those who participate in the offer and sale of digital securities may be deemed to be violating US federal securities laws. Additionally, states, including Texas and Delaware, have brought enforcement actions against token offerings and cryptocurrency. Private plaintiffs have also filed suit against token offerings that did not register with the SEC or qualify for an exemption, for which the remedy includes rescission (i.e., a full refund of the invested amount to the purchaser).

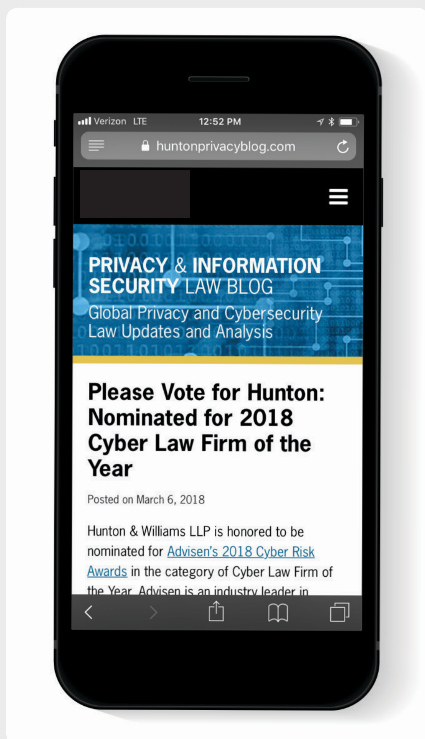
There also remains ambiguity around the jurisdiction of various federal agencies to regulate digital tokens and cryptocurrency. The Commodity Futures Trading Commission ("CFTC") has declared cryptocurrency a commodity and has exerted its regulatory force accordingly. Additionally, depending on the characteristics of a digital token, it may be either a security, a commodity, or a hybrid of both. Nevertheless, ICOs continue to attract billions of dollars of investment, with many

traditional venture capital firms investing alongside other investors. The continued investment is a reflection of the evolution of ICOs, which are now being structured and executed with the assistance of counsel and in accordance with applicable securities laws.

### Blockchain's Lasting Impact

Cutting through the noise and hype around ICOs and cryptocurrency, businesses have identified blockchain as a valuable tool in a variety of contexts. IBM and Walmart are working together with a growing number of prominent food retailers to create a food safety blockchain that has already decreased the time it takes to identify the source of on-the-shelf foodstuff from one week to 2.2 seconds. Auto manufacturers like Volkswagen and Toyota are working on blockchain-based solutions for tracking vehicle use and health data and managing data from autonomous vehicles. Energy companies are using blockchain to make grids more efficient and enable peer-to-peer trading of self-generated energy between households. De Beers has invested in a diamond-tracking blockchain to transform diamond supply chain transparency and traceability. Chinese companies JD.com and Alibaba quietly announced at the end of 2017 that they have been developing a blockchain for the past two years to combat counterfeiting and improve the transparency of the supply chain.

The volume of investment in blockchain projects so far in 2018 indicates that this will be an exciting year for blockchain's continued development. Blockchain has the potential to do for the transaction of assets what the internet did for communications. It is not the answer to all problems, however, and blockchain may prove inefficient in certain contexts. The businesses getting involved now at this early stage are placing a bet on blockchain's prolific potential and are shaping how the technology matures as a valuable business tool.

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## INSURANCE M&A

**Syed Ahmad**
*Partner, Insurance Coverage, Washington*

**Patrick McDermott**
*Associate, Insurance Coverage, Washington*

**Richard Warren**
*Partner, Mergers & Acquisitions, Richmond*

### R&W Insurance

The use of transactional insurance continues to rise. The most common is representation and warranties insurance, which can provide protection for buyers and sellers for breaches of representations and warranties in M&A transactions. As the use of R&W insurance increases, disputes over coverage under R&W policies are also likely to increase. While many policies require arbitration of any such disputes, 2017 saw a federal appellate court ruling on R&W coverage. *Ratajczak v. Beazley Solutions Ltd.*, 870 F.3d 650 (7th Cir. 2017).

That case involved a seller-side "warranty and indemnity" policy that Beazley had issued to the sellers of a business that sold whey protein concentrate. After the sale, the buyers accused the sellers of using an additive to produce falsely high protein levels in the concentrate. The buyers presented the sellers with a draft complaint containing a variety of claims, including for breach of certain representations and warranties in the stock purchase agreement. The sellers did not notify Beazley of the claim until two business days before they settled with the buyers for $10 million. Beazley denied coverage for the settlement, leading the sellers to sue Beazley.

The Seventh Circuit upheld Beazley's denial of coverage because the policy's terms did not cover the settlement and because Beazley did not consent to the settlement.

The policy covered losses "which the Insured is contractually obligated to pay" and had a self-insured retention ("SIR") of $1.5 million. Under the stock purchase agreement, there was no cap on the seller's liability for breach of "fundamental representations" and there was a $1.5 million cap on the seller's liability for breach of other representations and warranties. The buyer's draft complaint against the sellers alleged that the sellers had breached general warranties, among other things. It did not allege that the sellers had breached any fundamental representations. Thus, under the stock purchase agreement, the seller's exposure for breaches of the stock purchase agreement alleged in the draft complaint was capped at $1.5 million. Given that the Beazley policy had a $1.5 million retention, the court found no coverage under that policy.

The sellers argued that if that was true, why would they have settled for $8.5 million more than they were required to pay pursuant to the terms of the stock purchase agreement? The court rejected that rhetorical inquiry, explaining that there was no similar cap on the non-contractual (and non-covered) claims in the draft complaint such as fraud. Although it seems likely that the sellers understood the buyer's claim to include breaches of fundamental representations, the court was unwilling to look beyond the stated claims contained in the draft complaint.

In addition, the court upheld the denial of coverage based on the policy's requirement that Beazley consent to any settlement. Beazley had not consented to the settlement. The court rejected the sellers' argument that Beazley could not show any related prejudice from the alleged delay in providing notice or Beazley's failure to consent, pointing to the lack of any provision in the policy requiring that Beazley show prejudice. Moreover, according to the court, this case showed why there was no such prejudice requirement since, as the court explained, providing notice two business days before executing the settlement did not allow the insurer to adequately study the proposed settlement.

The *Ratajczak* decision contains an important reminder. Policyholders should carefully consider policy provisions related to notice and settlements after a claim or potential claim arises as non-compliance can lead to forfeiting coverage. Involving the insurer as early as possible in any such claim can help reduce an insurer's ability to raise technical defenses to coverage. Based on the facts described in the *Ratajczak* case, providing earlier notice to Beazley would have eliminated the insurer's ability to deny coverage based on lack of adequate notice (and therefore failure to obtain consent). It would also have given the insured more time to properly assess its liability under the stock purchase agreement and how such liability could successfully be covered by the policy.

## Other Transactional Insurance

Businesses should remain cognizant of tax indemnity and credit insurance, which can help reduce future exposure related to tax liabilities and credits, and contingent liability insurance, which can help reduce risk related to known potential liabilities. As an example, contingent liability insurance can help manage risk related to data breaches, which continue to become more and more frequent and costly. Exposures related to data breaches can be particularly troublesome to account for given that it can take months and even years to uncover the cause and extent of a breach. Contingent liability insurance can help reduce the unquantified risks related to known data breaches.

## Cyber Insurance

Cyber insurance programs also play a key role in many mergers and acquisitions as they can be an important part of a buyer's analysis of the future liabilities arising out of known or potential data breaches, which may impact the ultimate sale price. While the limits available under a cyber insurance program are a key part of the analysis, the terms of the coverage are equally important given the broad variances among insurers offering cyber coverages. Thus, ensuring adequate cyber insurance coverage—both in limits and coverage provisions—before any acquisition can be key to sellers, and analyzing available coverage, including the unique terms of the cyber policies, can be key to buyers.

# INSURANCE DUE DILIGENCE

**Michael Levine**
*Partner, Insurance Coverage, Washington*

## Due Diligence

Commercial transactions, particularly mergers and acquisitions, usually involve an immense amount of due diligence by the transacting parties. Deal-related due diligence entails a comprehensive review of the seller's business or assets to confirm information typically received from the seller and its advisors.

Due diligence helps get the right deal at the right price, reduces risk (and related costs) of a failed deal, and helps get to the right contract (addressing known issues, appropriate closing conditions, and post-closing protections). However, even the right contract may provide insufficient protections. For instance, the seller may not be willing (or able) to provide sufficient post-closing indemnification and, even some issues cannot be cured with dollars. It is important, therefore, that the party engaging in pre-deal due diligence use the information obtained to structure effective risk transfer mechanisms to minimize post-closing risk.

Certain areas of due diligence inquiry are of particular significance from a risk management and risk transfer perspective. These include insurance, non-insurance contractual risk transfer and the duty to indemnify for liability, and/or the cost of defense as a consequence of a deal-gone-bad. These issues and areas of inquiry are likely embedded in a myriad of routine business contracts and agreements. A few examples of typical hiding places where contractual risk transfer provisions might be found include:

- Guaranties, loan documents, and credit agreements
- Customer and supplier contracts
- Partnership and joint-venture agreements, limited liability company agreements, and operating agreements
- Settlement agreements
- Past acquisition agreements
- Equipment leases
- Indemnification agreements
- Employment and subcontractor agreements
- Exclusivity agreements
- Non-compete agreements
- Real estate leases and purchase agreements
- Licensing agreements
- Powers of attorney
- Franchise agreements
- Equity finance agreements
- Distribution, dealer, sales agency, or advertising agreements
- Union contracts and collective bargaining agreements

It is incumbent, therefore, that due diligence teams exercise vigilance when reviewing transaction materials to identify all indemnification and risk transfer provisions beyond those that exist in common insurance policies. Indeed, while insurance policies are of utmost importance and value for purposes of insulating against fortuitous loss, significant value (or risk) also may lie embedded in the contracts and agreements that transfer liability as part of their ordinary terms. Competent transactional due diligence can help identify and measure both the value and the risk embedded in such agreements.

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# CORPORATE AND SECURITIES LITIGATION TRENDS

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Delaware, long considered to be the leader in the area of corporate law, allows a wide range of shareholder claims to be brought directly through shareholder class actions rather than through a derivative action on behalf of the corporation. The distinction is significant: shareholders can only bring derivative actions when they satisfy a pre-suit demand requirement, and can only maintain such actions so long as they remain shareholders. Shareholders are not so limited as to when they can bring direct actions.

Delaware has had to contend with an explosion of shareholder litigation, particularly in the M&A context, in the last 15 years. In response, Delaware has cracked down on so-called disclosure-only settlements, and has given greater emphasis to shareholder approval of a merger in a fully informed, uncoerced vote. But other states are taking a different approach. Recent decisions in North Carolina and Massachusetts, both states that have adopted the Model Business Corporation Act (the “Model Act”), make clear that in those states shareholders can only bring challenges to the consideration paid in merger transactions derivatively rather than directly. These decisions reflect a break from the approach taken in Delaware and several other states, and offer greater protections to corporations, their boards, and their officers when faced with shareholder litigation.

## Delaware’s Tooley Test

In 2004, the Delaware Supreme Court issued its opinion in *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, which changed the analysis as to whether a claim brought by a shareholder is considered direct or derivative. Prior to *Tooley*, Delaware courts reasoned that injuries to all shareholders in the same proportion based on their stock ownership were derivative of injuries suffered by the corporation. But in *Tooley* the Delaware Supreme Court established a two-factor test centered on two questions: who suffers the injury, and who would receive the benefit of any recovery or remedy? The court reasoned that, in Delaware, fiduciary duties run to both shareholders and corporations, and that a direct action will lie where the injury and the recovery flows to the shareholders themselves, and not to the corporation. Accordingly, injuries suffered by a shareholder could be pursued through direct claims, even when all shareholders suffer the same injury. The upshot was an increased volume of shareholder actions because shareholder challenges to merger consideration could be brought as direct class actions.

Although several states have adopted the test in *Tooley*, some Model Act states have adhered to a simpler approach that requires a greater range of shareholder claims to be brought derivatively.

## Corwin v. British American Tobacco PLC

In 2016, in *Corwin v. British American Tobacco PLC*, the Court of Appeals of North Carolina affirmed a ruling finding that a shareholder suit alleging inadequate consideration in a merger transaction was a derivative action, not a direct action. The court noted that in North Carolina, "a director's fiduciary duty is owed to the corporation itself and not to the shareholders individually." This is a departure from the law in Delaware.

A shareholder in North Carolina may bring an action directly only if he or she can allege facts showing that the director owed him or her a "special duty beyond that of a general fiduciary duty to the corporation." That duty may arise from a contract between the shareholder and the corporation, but cannot simply derive from the director's duties to the corporation itself. Alternatively, the court stated that a direct action may lie where a shareholder can allege an injury "peculiar or personal to themselves." The court then rejected the notion that general diminution in stock value or dilution of voting power can constitute such an injury. Diminution in stock value is essentially an injury to the corporation, and dilution of voting power is felt by all shareholders generally. Those injuries, therefore, could not give rise to a direct action.

While the court in *Corwin* did not mention *Tooley*, it clearly rejected the Delaware test in favor of its inquiry as to whether the shareholder suffered a unique injury.

## International Brotherhood of Electrical Workers Local No. 29 v. Tucci

More recently, the Supreme Judicial Court of Massachusetts reached a similar result in dismissing a direct action brought by shareholders challenging the price obtained in a merger of a Massachusetts company. The court started its analysis stating that "a court must inquire whether the shareholder's injury is distinct from the injury suffered generally by the shareholders as

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owners of corporate stock." If the injury is the same, it cannot be said that any harm resulted from a breach of duty owed directly to the shareholder rather than a breach of duty owed to the corporation itself.

The court also noted that the Massachusetts statute, which, like North Carolina's, is also based on the Model Act, requires directors to discharge their duties in a manner the director believes to be in the "best interests of the corporation." While the directors may consider the interests of the shareholders in making that determination, the statute imposes duties on the directors only to the corporation itself. The court then found that the alleged wrong, the undervaluing of the company stock, qualified as an injury to the corporation. To the extent that plaintiff's shares were undervalued, that was solely a consequence of the injury to the company and plaintiff's claim could only be brought derivatively.

The court specifically rejected application of *Tooley* in Massachusetts. It noted that Delaware's statute is different from the Model Act, and that Delaware has a history of finding that directors stand in a fiduciary relationship with stockholders, in contrast to Massachusetts precedent.

## Conclusion

The line of cases following *Tooley* has expanded the number of shareholder challenges based on merger consideration that have survived as direct actions. As seen in recent decisions in North Carolina and Massachusetts, however, that line of cases is far from universally applied, and Model Act states appear poised to push back against the growing number of direct actions being filed challenging the consideration paid to shareholders in mergers.

# TRENDS IN TECH M&A

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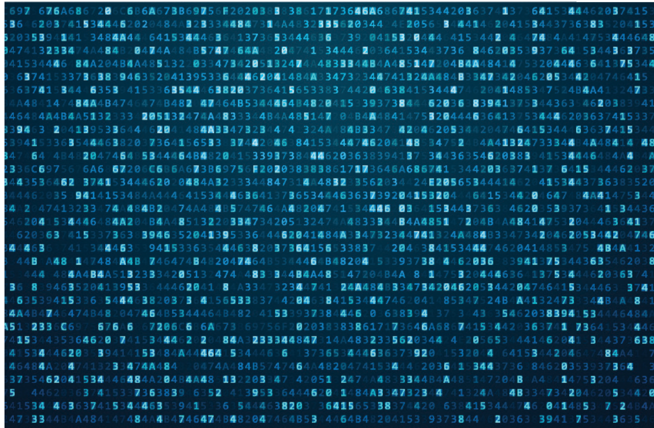
The rapid advancement of technology has been transformative to the success of nearly all of our clients. The past several years have seen steady increases in both the volume and valuations of technology-related transactions, which are near the heights of the tech dealmaking boom experienced just prior to the 2000 dot-com crash. As technology has become ubiquitous in our lives and in virtually every industry, it has become increasingly difficult to differentiate between a "technology-related" transaction and any other transaction. From traditional technology fields like communications, software, hardware manufacturing, and systems integration to the more recent explosive growth in wireless technology, online retail, social media, "Internet of Things," and data analytics, the global business landscape is being revolutionized.

As in the past, M&A activity is driven by the "build or buy" paradigm faced by competitors in a rapidly changing marketplace. One important element of the growth in technology M&A is the desire of companies in non-tech sectors to acquire technology (often data capture and analytics) and related intellectual property to gain an edge in their industry or to expand into new the markets. We have seen this in industries like finance, real estate, and insurance, where big data and data analytics have opened the way to new business opportunities and a transformation of the way companies interact with clients, customers, and suppliers. Much of the M&A activity in these sectors is driven by innovation advanced by discrete entrepreneurs and software developers which attracts larger, more traditional competitors looking to acquire such innovation rather than independently build the desired capabilities.

As a result of the geographic scope and substantive depth of our domestic and international M&A practice, we have had the opportunity to assist clients in all aspects of this expanding and evolving market. Here we will focus on just a few of the developments we have encountered in the technology M&A marketplace.

### Where is it? ... "It's in the Cloud"

As mainframe computing has given way to the cloud, one area of explosive new growth has been software-as-a-service ("SaaS"). SaaS is one of several technologies that utilize shared pools of system resources that can be scaled to each customer's particular needs, often accessible over the internet through an interface as simple as a web browser. Our clients view SaaS technology as an especially attractive asset due to its scalable nature, which allows for broader access to distinct markets without compromising stability or functionality.



We have helped clients acquire SaaS technology for both internal and external uses, as SaaS's abilities can supplement numerous aspects of a company's operations and products, including management of hardware, software updates and testing, and cybersecurity matters, as well as mobile platform connectivity. Our recent representation of public and private clients in the acquisition of SaaS cloud-based technology has highlighted the importance of having the intellectual property ("IP") legal skills necessary to understand the transfer of both proprietary and open-source IP resources.

We expect to see continued interest in SaaS technology transfers and acquisitions, as SaaS deal volume is projected to reach over 45% of total software transactions in 2018.

## AI, Robot, and Machine Learning

Another technology market expecting to receive significant investment in 2018 is artificial intelligence ("AI"). The ubiquity of Apple's Siri, Amazon's Alexa, and other AI virtual assistants has piqued consumer curiosity, and the potential application of AI in everyday activities has led to a significant uptick in AI-related M&A activity, namely in the marketing, health care, and e-commerce sectors. While much of this increased M&A activity can be attributed to acquisitions by tech-based companies (e.g., Microsoft, Apple, Facebook, etc.), like SaaS M&A, non-tech companies also contributed to the acceleration of AI deal volume, exemplified by 2017's marked increase in the number of AI-targeted deals, which was up over 175% as compared to 2016's deal flow.

The importance of software and software developers to AI businesses mandates that careful attention be paid not only to the IP aspects of the transaction, but also to the human element. Careful consideration of representations around IP ownership, employee confidentiality, and IP development agreements, and covenants relating to employee/developer retention and compensation, are critical to the success of M&A transactions in this space.

New applications for AI technology across various industries, including self-driving vehicles, data analytics, and "Internet of Things" development, show no signs of slowing, and we expect 2018 to be another banner year for AI-driven M&A activity.

## Structuring Tech Transactions + Legal Considerations

Typically, our clients view tech M&A as a core part of their business plans and consider these acquisitions an integral component of their long-term corporate strategy. Moreover, many acquirers view technology acquisitions as a supplement to, and not a substitute for, an existing tech-based asset portfolio and acquire new technology to create synergies with their proprietary in-house innovations. These acquisitions require careful planning and execution, as the characteristics of each deal can vary significantly from M&A transactions in more traditional industries. Key elements of such transactions can include:

- efficient tax structuring, as these transactions most often involve "soft" rather than "hard" assets;
- timing and secrecy considerations, as employee/developer retention is often a key element in these transactions;
- understanding the critical assets of the target and how the acquirer plans to deploy them to help in crafting appropriate representations, warranties, and covenants;
- understanding the acquirer's plans for the target's personnel so that the acquirer can safeguard critical IP, properly incentivize retained employees, and "manage" the throughput of non-retained employees; and
- understanding the acquirer's risk tolerance to determine whether representation and warranty insurance is an appropriate solution or to craft appropriate indemnity provisions.

Efficient tax structuring and planning is, as always, unique to each client and depends on a number of factors, including the client's organizational structure, its home jurisdiction, the planned use of the acquired assets, and any plans relating to the eventual disposition of the assets or the business. Our lawyers have the depth and experience to guide our clients through both domestic and international rules and regulations relating to the taxation and amortization of software and IP assets and the efficient movement of revenues and profits through the corporate structure.

Understanding the importance of timing and flexibility is often vital to a successful tech-related transaction. In the fast-moving technology sector, targets are often eager to sell to the highest bidder that is willing to close quickly. Acquirers should be ready to fast-track the business and legal due diligence processes, be responsive during the negotiation of the transaction documents, and work closely with the target's upper-level management to close the deal quickly and efficiently. In this regard, we have seen an increase in the use of representation and warranty insurance as a means to short-circuit protracted negotiations over the breadth of the seller's representations and warranties and the duration, scope, dollar limitations, and procedures around indemnity provisions. We have found that private equity investors in the tech space have been both early adopters and strong supporters of this type of insurance.

Flexibility is also a critical aspect of tech acquisitions, as these investments can often require buyers to be creative and use less-traditional deal structures, such as minority investments, earn-outs (in the case of fast-growing businesses with relatively short track records), and equity incentives to retain founders and critical employees like lead developers. In addition, developing an understanding of and appreciation for the target's culture, business model, and innovation incentives can be crucial to a successful post-closing integration, retention of key personnel, and the realization of anticipated synergies.

Technology and tech-driven enhancements will continue to impact virtually all industries. The pace of change and new developments will dictate that M&A remain an important strategic consideration in the drive to remain competitive and to outpace rivals. We anticipate continued growth in both the number and value of tech-driven M&A transactions in 2018 and beyond. We remain committed to keeping abreast of the latest developments in this market to better meet the needs of our clients as they navigate the ever-changing tech M&A landscape.

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

## DELAWARE DEVELOPMENTS IN 2017

**Steven Haas**
*Partner, Mergers & Acquisitions, Richmond*

2017 did not bring about any drastic changes in Delaware law, but we have summarized below a few noteworthy developments in M&A and corporate governance.

### Stockholder Ratification Under *Corwin*

Delaware courts continued to apply the "*Corwin* doctrine" to post-closing challenges to M&A transactions with third-party buyers. Under *Corwin*, the fully informed and uncoerced vote of a majority of disinterested stockholders will invoke the business judgment rule. Once the business judgment rule applies, the plaintiff's complaint will be dismissed unless the merger constitutes "waste," which is a difficult claim to prove.

In 2017, several Delaware court decisions relied on *Corwin* to dismiss challenges to mergers with third parties following a stockholder vote, but there were a few notable exceptions. In *Saba Software*, for example, the court said *Corwin* did not apply because the stockholders of a financially distressed company were inequitably coerced into approving the merger. In *Sciabacucchi v. Liberty Broadband*, the court held that *Corwin* did not cleanse a stock issuance to the company's largest stockholder. There, the court reasoned that the stockholder vote was "structurally coerced" because in order to approve a merger and receive its benefits, the stockholders also had to approve the stock issuance, which the plaintiffs alleged was "extraneous" to the merger. And in yet another case, *Van der Fluit v. Yates*, the court decided that *Corwin* did not apply because the stockholder vote did not appear to be fully informed. In that case, the company allegedly did not disclose all material facts concerning management's role in negotiating the transaction, although the court ultimately dismissed the complaint for failing to plead a non-exculpable breach of fiduciary duty.

*Corwin* continues to be a powerful tool to obtain dismissal of lawsuits following a stockholder vote. But, as evidenced by the decisions noted above, the full contours of the *Corwin* doctrine have not been fully developed.

### Appraisal Claims in M&A Transactions

In recent years, there has been an uptick in the number of appraisal actions in which stockholders dissent from mergers and request a judicial determination of the "fair value" of their stock. Most of these petitions are generally filed by hedge funds that acquire their shares after the merger is announced.

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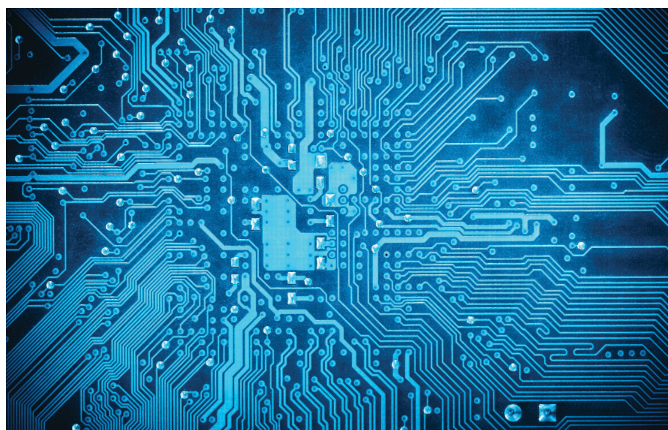
In 2017, the Delaware Supreme Court issued two noteworthy appraisal decisions. In *Dell v. Magnetar Global Event Driven Master Fund Ltd.* and *DFC Global Corp. v. Muirfield Value Partners, L.P.*, the Delaware Supreme Court strongly suggested that the final merger price negotiated by the target and buyer will usually be the best evidence of "fair value" when the target has conducted a broad market check. Also in 2017, the Court of Chancery issued its decision in *In re Appraisal of SWS Group, Inc.*, in which it found that the statutory "fair value" of the petitioners' shares was 8% *less* than the merger price. There, the court emphasized the fact that the appraisal statute requires the court to ignore synergies arising from the transaction.

## Migration of M&A Litigation From Delaware State Courts to Federal Courts

The number of M&A lawsuits filed in Delaware state court continues to decline due to a number of developments that have curbed abusive and meritless claims. There has been an increase, however, in the number of M&A lawsuits filed in federal court. According to Cornerstone Research, nearly half of the federal securities class actions filed in 2017 involved M&A transactions. In addition, the number of federal class actions challenging M&A transactions in 2017 was more than double the number of such suits in 2016. These lawsuits allege violations of federal securities laws and are often brought by the plaintiffs' bar to avoid the scrutiny applied by the Delaware state courts to such claims. Some of these lawsuits have resulted in the targeted companies' providing supplemental disclosures to "moot" the claims and thus avoid the risk that a federal court enjoin the proxy solicitation or the transaction.

## Outside Director Compensation

Finally, in *In re Investors Bancorp*, the Delaware Supreme Court held that equity compensation awards for outside directors will be reviewed under the stringent "entire fairness" standard rather than the business judgment rule unless (i) the equity awards were specifically approved by stockholders or (ii) the equity awards were made pursuant to a formula under a stockholder-approved compensation plan. This ruling will likely result in changes to new director equity compensation plans going forward.



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