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HOW BREXIT MIGHT IMPACT M&A: AN ANTITRUST PERSPECTIVE

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As has been widely covered, in a nationwide referendum held on June 23, 2016, the United Kingdom ("U.K.") voted to leave the European Union ("EU"). The result of the referendum is not binding on the U.K. government; it is advisory in nature only. The U.K. Prime Minister, David Cameron, who had called the referendum and campaigned for the U.K. to remain in the EU, resigned following the vote. His successor, Theresa May, has indicated that she will respect the vote. She confirmed this by using the intriguing phrase "Brexit means Brexit." The phrase is intriguing because it is not clear that anybody, the Prime Minister included, understands what that actually means.

An important—potentially critical—question is whether the U.K. will remain part of the EU internal market, also known as the single market.

The internal market is the free trade zone covering the 28 members of the EU together with Iceland, Norway and Lichtenstein. These 31 countries make up the European Economic Area ("EEA"). The laws governing the operation of the internal market—such as product regulations and environmental standards —are devised at the EU level and either directly become part of the laws of each EU Member State or are transposed by national governments into national legislation. Only EU members (not Norway, Iceland or Lichtenstein) have a say in the formation and content of those laws. Membership of the internal market gives companies in one Member State the ability and right to provide goods and services in any other Member State and face no regulatory hurdles in doing so, in addition to those they face in their home Member State (subject to certain exceptions).

There is a variety of options available to the U.K. as regards its future relationship with the EU. They include:

- remaining in the EU;
- leaving the EU but remaining in the EEA;
- leaving the EEA but negotiating access to the internal market via an Association Agreement;
- negotiating a bespoke standalone trade agreement with the EU (Canada has

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respectively. It is worth flagging also that U.K. merger notifications are expensive compared to notifications to the European Commission. There is a filing fee of up to £160,000 (there is no filing fee under the EUMR) and professional fees tend to be higher in the U.K. due to a need to provide more information to the CMA than to the European Commission and have greater interaction with the CMA case teams.

An additional impact on the EUMR will be fewer deals qualifying for review by the European Commission. As noted above, the merging parties' EU-wide revenues need to meet certain thresholds for an EU merger filing to be triggered. Following Brexit, companies' U.K. revenues will no longer count towards EU-wide thresholds. This may mean that some deals will fall short of the EUMR qualifying threshold and one or more national filings will need to be made within the EU instead—as with the introduction of dual EUMR and U.K. merger filings described above, this is likely to result in more red tape, more uncertainty and greater delay.

How to Deal with the Run-up to Brexit

In the run-up to Brexit, companies doing M&A involving a business with revenues in the U.K., which need to notify the deal for merger clearance under the EUMR, should consider their notification and—if relevant—divestment strategy. If Brexit is likely to occur while the deal is under review at the European Commission, the acquirer ought to consider engaging with the CMA at the outset and making sure it is on board with the filing strategy. In particular, if divestments need to be offered to the European Commission as a condition of clearance, it would be prudent to discuss them with the CMA to ensure that they address any national concern in the U.K. Failure to do so could result—in theory—in the parties completing the deal and then finding the CMA wanting to investigate it under U.K. merger laws: filings in the U.K. are voluntary, meaning that parties can complete deals without notifying them, but run the risk of a post-completion merger investigation.

Finally, if Brexit involves trade barriers being erected between the U.K. and the EU, the assessment of a deal on competition on both sides of the English Channel may differ from an analysis conducted today. This is because companies in the U.K. may find themselves less constrained by rivals in the EU, and vice versa. This in turn could lead to more concentrated markets—in particular, more national markets limited to the U.K.—and a greater risk of in-depth merger investigations and the need to give divestments or behavioral undertakings in order to obtain antitrust clearance.

Conclusion

The U.K.'s vote to leave the EU has heralded a period of uncertainty for businesses that can be expected to last for several years. In the immediate term, it offers opportunities for M&A activity in the U.K., given the devaluation in the pound and the fact that the U.K. remains a business-friendly economy. In the more medium term, however, a likely impact on M&A will be more regulatory hurdles and transaction costs—and a need to ensure that your antitrust advisers are on top of their game to help you navigate a new, and more complex, regulatory environment.

SINGH V. ATTENBOROUGH: DELAWARE SUPREME COURT DEALS ANOTHER BLOW TO STOCKHOLDER PLAINTIFFS IN M&A LITIGATION

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What began as an all-too-common stockholder challenge to a public company merger became a case that helped usher in a new era of stockholder litigation in which fewer deals are challenged, and fewer of those challenges survive the pleadings stage.

The litigation arose from Signet Jewelers Limited's agreement to acquire its competitor Zale for $21 per share. Zale stockholders sued and sought a preliminary injunction, which the Delaware Court of Chancery denied. Undeterred, the plaintiffs amended their complaint post-closing, asserting claims against the sell-side directors, their financial advisor, and the acquiror. The Court of Chancery ultimately dismissed the plaintiffs' claims, and the plaintiffs appealed to the Supreme Court of Delaware.

The plaintiffs lost again on appeal. The Supreme Court's summary order affirming the dismissal of the case is relatively short, but substantively significant in two important ways that have implications beyond the result of the case. First, the Supreme Court made clear that, except in cases in which the entire fairness standard of review applies from the outset, a fully informed, uncoerced vote of a majority of a company's disinterested stockholders restores the business judgment rule standard of review. Importantly, the Supreme Court observed that "[w]hen the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result." Second, the Supreme Court made clear that an investment bank's business pitch to an acquiror is not, without more, a conflict that would give rise to secondary liability. In so doing, the Supreme Court emphasized that the "knowing participation" element of aiding and abetting liability required a stockholder plaintiff to allege and prove scienter—bad-faith conduct that typically will not occur in the context of a deal absent unusual circumstances.

After a summary of the background facts and an overview the litigation's progression through the Delaware Courts, this article explores the case's resulting legal implications and practical lessons below.

Background Facts

Despite producing four separate judicial decisions,[1] the litigation never advanced beyond the pleadings stage. As a result, the following facts, which formed the basis for those judicial decisions, are based on the plaintiffs' allegations and the Court of Chancery's synopsis of the preliminary injunction record.

On October 7, 2013, a Merrill Lynch team pitched Signet Jewelers about several strategic alternatives, including an acquisition of Zale. In its pitch to Signet, Merrill Lynch indicated a range of values for Zale of $17-$21 per share. Importantly, Merrill Lynch created its pitch materials based on public information and without the use of Zale's confidential information.[2]

Weeks later, Signet made an unsolicited proposal to acquire Zale for $19 per share. Zale engaged Merrill Lynch to advise the sell-side board in its negotiations with Signet. At the time, Merrill Lynch represented that it had "limited prior relationships and no conflicts with Signet."[3]

With a Merrill Lynch team led by the same individual who led the bank's October 7 pitch advising the board, Zale pursued a single-bidder strategy, negotiating directly with Signet. Zale and Signet jointly announced the merger on February 19, 2014. Fortuitously, the $21-per-share merger price was equal to the top end of the illustrative range that Merrill Lynch had put on Zale in its pitch to Signet.[4]

In connection with the preparation of the proxy after the merger agreement was signed, Merrill Lynch revealed to Zale that it had met with Signet in October 2013, and that its pitch included a discussion of an acquisition of Zale for $17-$21 per share. Following this disclosure, the Zale board met three times before concluding that "Merrill Lynch's presentation to

Signet did not impact the Board's determination and recommendation regarding the merger."[5]

The Preliminary Injunction Decision

In what has largely become a vestige of a bygone era in M&A litigation,[6] the plaintiffs filed suit and moved for a process-based preliminary injunction. More specifically, the plaintiffs argued in support of their preliminary injunction motion that the Zale directors breached their *Revlon* duties by failing to conduct a pre-signing market check. The Court of Chancery denied the motion, noting that "[t]here is no per se duty under Delaware law to conduct a pre-signing market check in a *Revlon* situation," and concluding that the Zale directors demonstrated "that they had a sufficient and reliable body of evidence from which they could evaluate the fairness of the transaction without conducting an active survey of the market." The Court of Chancery further expressed its view that while the single-bidder process was less than ideal, there was "nothing so unreasonable or untoward about the manner in which the Zale board conducted itself that would justify the extraordinary relief" of a preliminary injunction.[7]

The Court of Chancery also presaged a significant development in the law, observing that "[i]n the absence of any apparent serious misconduct, the question of whether the board appears to have utilized a sufficient process and obtained the best deal for the company should be answered, at least in the immediate term, by the stockholders themselves at the vote on the transaction, as long as that vote is fully informed."[8] On that score, the Court rejected the plaintiffs' two principal arguments that the proxy omitted any material information. First, the plaintiffs argued that the proxy failed to disclose a "Present Value of Future Stock Price Analysis" that was presented by Merrill Lynch to Zale's board. The Court rejected this argument, concluding that the omitted analysis was not material because it "was not relied on by [Merrill Lynch] in reaching its fairness determination." Second, the plaintiffs argued that the proxy failed to adequately explain why two different sets of projections were disclosed. The Court rejected this argument, holding that the two sets of projections were characterized fairly and adequately in the proxy, and observing that both sets of projections "were actually considered to some extent by [Merrill Lynch] and by the board in their considerations and, therefore, it was appropriate that both of them be disclosed in the proxy materials that were generated."[9]

The plaintiffs' motion for preliminary injunction was therefore denied, a majority of Zale's stockholders approved the merger, and the deal closed. From the plaintiffs' perspective, their preliminary injunction motion bore fruit in the sense that they obtained expedited discovery, which they used to amend their complaint post-closing. But as explained below, the Preliminary Injunction Decision—particularly with respect to the disclosure claims—would loom large going forward.

The Motion to Dismiss Decision

The plaintiffs asserted three claims in their post-closing complaint: (1) breach of fiduciary duty claims against the Zale board; (2) an aiding and abetting claim against Signet; and (3) an aiding and abetting claim against Merrill Lynch. All of the defendants moved to dismiss, arguing, among other things, that the Zale stockholders' approval of the merger invoked the protections of the business judgment rule standard of review under the Court of Chancery's *KKR* decision and prior precedent.[10]

The Court of Chancery observed that the predicate facts for application of *KKR* were present in *Zale*—namely, the approval of the merger by a fully informed and disinterested stockholder majority. But, recognizing that *KKR* was on appeal, the Court declined to apply it, and instead evaluated the complaint under *Revlon*'s intermediate scrutiny rather than the business judgment rule.[11]

Applying *Revlon*, and taking into consideration the exculpation clause in Zale's charter, the Court of Chancery dismissed the fiduciary duty claims against the Zale directors. The Court also dismissed the aiding and abetting claims against Signet, concluding that there were no allegations in the plaintiffs' complaint "that would support an inference that Signet knowingly participated" in any breach of duty by the Zale directors. Merrill Lynch's dismissal motion, however, was denied. In particular, the Court permitted the plaintiffs' claim against Merrill Lynch to proceed on the theory that the Zale directors breached their duty of care by not discovering sooner that its bankers had pitched the acquiror only weeks before the sale process began, and that Merrill Lynch's belated disclosure of the pitch stated a claim for aiding and abetting the directors' breach.[12]

The Reargument Decision

Less than 24 hours after the Motion to Dismiss Decision, the Supreme Court of Delaware affirmed *KKR* on appeal. Specifically, the Supreme Court held that "the Chancellor [in *KKR*] was correct in finding that the voluntary judgment of the disinterested stockholders to approve the merger invoked the business judgment rule standard of review."[13] Merrill Lynch promptly moved for reargument, arguing that following *KKR* the Court of Chancery should reconsider whether the Zale directors committed even a breach of their duty of care under the business judgment rule, rather than the *Revlon* standard of intermediate scrutiny.[14]

The Court of Chancery ultimately agreed, and concluded that *KKR* required it to reassess the board's conduct and whether it amounted to gross negligence as would be required to rebut the presumptions of the business judgment rule. Applying that standard, the Court held that the plaintiffs had "not alleged sufficient facts to make it reasonably conceivable that the [d]irector [d]efendants breached their duty of care." As a result, the Court of Chancery dismissed the secondary liability claim against Merrill Lynch.[15]

The Supreme Court Decision

Plaintiffs appealed and the Supreme Court affirmed the Court of Chancery's dismissal of the case in a terse but substantively impactful two-paragraph order.

The first paragraph of the Supreme Court's order addressed the application of *KKR* and the legal effect of stockholder approval of a merger. In it, the Supreme Court reiterated "that a fully informed, uncoerced vote of the disinterested stockholders invoked the business judgment rule standard of review." The Supreme Court clarified, however, that gross negligence does not apply where the business judgment rule is invoked by a stockholder vote. Instead, all that remains is the "vestigial waste exception," which "has long had little real-world relevance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful." Thus, as the Supreme Court observed, "[w]hen the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result."[16]

The second paragraph of the Supreme Court's order addressed the secondary liability standards applicable to sell-side financial advisors. As a threshold matter, and as noted above, the Supreme Court expressed its skepticism that Merrill Lynch's late disclosure of its prior pitch to Signet "produced a rational basis to infer scienter." Separately, the Supreme Court emphasized that "Delaware has provided advisors with a high degree of insulation from liability by employing a defendant-friendly standard that requires plaintiffs to prove scienter and awards advisors an effective immunity from due-care liability," and contrasted that standard with the one faced by "most professionals" who "face liability under a standard involving mere negligence, not the second highest state of scienter—knowledge—in the model penal code." In so doing, however, the Supreme Court evoked the *Rural Metro* boogeyman in cautioning that the high threshold for secondary liability was not insurmountable in this setting and that "an advisor whose bad-faith actions cause its board clients to breach their situational fiduciary duties (*e.g.*, the duties *Revlon* imposes in a change-of-control transaction) is liable for aiding and abetting."[17]

Lessons and Implications

The Supreme Court packed a lot into just two paragraphs. When viewed in the context of the case, and against the backdrop of other recent cases, the Supreme Court Decision has important lessons and implications for M&A litigation generally, and for financial advisors specifically.

A fully informed, uncoerced approval by disinterested stockholders invokes the irrebuttable business judgment rule. Except in a squeeze-out transaction involving a controlling stockholder, when the sell-side stockholders approve a merger in a fully informed and uncoerced vote, or by tendering into the front end of a two-step acquisition as recently confirmed by the Court of Chancery,[18] claims against all defendants in M&A litigation, including financial advisors, will typically be dismissed. As a result, the accuracy and completeness of pre-closing disclosures to stockholders are paramount in terms of litigation risk management.

Advisors should make timely disclosure of potential conflicts. Although protected by the stockholder vote, the Court of Chancery made clear that the *Revlon*-based claims against Merrill Lynch would have otherwise survived on the basis that its belated pitch disclosure led the directors to breach their duty of care. Absent fully informed stockholder approval, therefore, the sell-side advisor would have been the last defendant standing, with the directors and acquiror being dismissed. As *Rural Metro* exemplifies, this is a dangerous place for a sell-side advisor to find itself. And, again, the Supreme Court explicitly warned that it would not permit the non-disclosure of facts by an advisor to insulate the advisor from liability.[19]

A pitch is not a conflict. Although the Supreme Court was "skeptical" that even the late disclosure of a "business pitch" that was explained to stockholders in the proxy could provide a basis for liability against the sell-side advisor, a timely disclosure is always better. Indeed, a timely disclosure can be a strategic advantage for an advisor; the Zale board could have chosen to hire Merrill Lynch on the strength of its relationship with Signet. And disclosure of the issue would likely have avoided the distraction and inconvenience of what became a more than two-year litigation.

Advisor conflicts exist on a spectrum. The Delaware courts have taken a more nuanced, sophisticated view of financial advisor conflicts.

Least troubling from a litigation risk perspective are certain recurring fact patterns that present the mere appearance of conflict, but no direct economic antagonism between advisor and client. These facts typically present marginal litigation risk, provided they are promptly disclosed to the board and/or target stockholders. Examples include a financial advisor's contingent compensation,[20] previous business relationship with the acquiror,[21] and general interest in establishing a future business relationship with the acquiror.[22]

Far more troubling are other recurring fact patterns that present actual conflicts in which the financial advisor's interests are economically adverse to those of its clients. These conflicts should promptly be disclosed, and steps should be taken to mitigate their effect, including by isolating deal team members from other aspects of the firm where conflicts may exist or bringing in a second advisor. Examples include a financial advisor's equity ownership of the acquiror[23] and its present, material interest in an actual or potential business relationship with the acquiror.[24]

ENDNOTES:

[1] In chronological order, they are: (1) *In re Zale*

Corp. S'holders Litig., C.A. No. 9388-VCP (Del. Ch. May 23, 2014) (Transcript) (the "Preliminary Injunction Decision"); (2) *In re Zale Corp. S'holders Litig.*, 2015 WL 5853693 (Del. Ch. Oct. 1, 2015) (the "Motion to Dismiss Decision"); (3) *In re Zale Corp. S'holders Litig.*, 2015 WL 6551418 (Del. Ch. Oct. 29, 2015) (the "Reargument Decision"); and (4) *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016) (Order) (the "Supreme Court Decision").

[2] *Preliminary Injunction Decision*, at 99-100.

[3] *Motion to Dismiss Decision*, at *3.

[4] *Id.* at *3-5.

[5] *Id.* at *17.

[6] *See, e.g.*, *City of Daytona Beach Police & Fire Pension Fund v. Examworks Grp., Inc.*, C.A. No. 12481-VCL, at 36 (Del. Ch. June 29, 2016) (Transcript) (positing that "we're in a post-*C&J* world where you're really not going to get an injunction without a topping bid") (citing *C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust*, 107 A.3d 1049 (Del. 2014)).

[7] *Preliminary Injunction Decision*, at 113-16.

[8] *Id.*

[9] *Id.* at 116-24.

[10] *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980 (Del. Ch. 2014), *aff'd sub nom. Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015).

[11] *Motion to Dismiss Decision*, at *8-10.

[12] *Id.* at *18-22. The director defendants were dismissed even under this theory by virtue of an exculpation clause, which protected them from personal liability for breaches of the duty of care.

[13] *Corwin v. KKR Fin. Holdings, LLC*, 125 A.3d 304, 306 (Del. 2015). The Supreme Court further rejected the plaintiffs' argument that the Court's prior *Gantler v. Stephens* decision requires courts "to give [an] informed stockholder vote no effect in determining the standard of review." *Id.* at 311.

[14] *Reargument Decision*, at *1-2.

[15] *Id.* at *2-5.

[16] *Supreme Court Decision*, at 151-52 (citations omitted).

[17] *Id.* at 152-53 (citations omitted).

[18] *See In re Volcano Corp. S'holder Litig.*, 2016 WL 3583704 (Del. Ch. June 30, 2016) (applying *KKR* to first-step tender of two-step "medium form" merger under 8 *Del C.* § 251(h), and concluding that the business judgment rule irrebuttably applies to the transaction at issue).

[19] *Supreme Court Decision*, at 151-52.

[20] *See In re Rural/Metro Corp. S'holders Litig.*, 88 A.3d 54, 94 (Del. Ch. 2014); *see also In re Atheros Commc'ns, Inc. S'holder Litig.*, 2011 WL 864928, at *8-9 (Del. Ch. Mar. 4, 2011).

[21] *See In re Art Tech. Grp., Inc. S'holder Litig.*, C.A. No. 5955-VCL, at 101-02 (Del. Ch. Dec. 20, 2010) (TRANSCRIPT).

[22] *See Supreme Court Decision*, at 152-53.

[23] *See generally In re El Paso Corp. S'holder Litig.*, 41 A.3d 432 (Del. Ch. 2012).

[24] *See RBC Capital Mkts., LLC v. Jervis*, 129 A.3d 816 (Del. 2015); *In re Rural/Metro Corp. S'holders Litig.*, 102 A.3d 205 (Del. Ch. 2014); *In re Rural/Metro Corp.*, 88 A.3d 54.

HOSTILE TAKEOVERS, PROXY FIGHTS AND INSURANCE HOLDING COMPANIES

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Although hostile takeover attempts in the insurance industry have been infrequent in the last 30 years, the environment may be changing. In 2015, several announced insurance mega-mergers (ACE /Chubb, Anthem/Cigna, Aetna/Humana) left insurer boards of directors wondering if they should be next in line to merge, or if they would be next up on another company's radar screen. These deals followed close in time after Endurance Specialty Holdings' hostile overtures to Aspen Insurance Holdings in 2014, and at the same time as Exor SpA's hostile overbid for PartnerRe Ltd. In addition, the well-publicized challenge by Carl Icahn to AIG's strategic direction also may have left some insurers looking over their shoulders. Even if not hostile takeover targets, insurers now are more often finding themselves under the unaccustomed scrutiny of activists.

