I am pleased to present the 2009 Strategic Buyer/Public Target Deal Point Study (the “2009 Study”) which was recently published by the M&A Market Trends Subcommittee (the “Market Trends Subcommittee”) of the Mergers & Acquisitions Committee of the American Bar Association’s Business Law Section (the “M&A Committee”). The 2009 Study tracks commonly negotiated deal points in acquisition agreements by strategic buyers involving public company targets that were entered into in 2008. Given the differing deal structures and terms, the 2009 Study excludes acquisitions of public company targets by private equity buyers, which is the subject of a separate study published by the Market Trends Subcommittee.

I want to take just a moment to thank the M&A lawyers from approximately 20 law firms for their hard work as members of the 2009 Study’s Working Group. I also want to thank my Co-Chair of the Market Trends Subcommittee, Jessica Pearlman of K&L Gates LLP, and my M&A Committee colleagues Keith Flaum of Dewey & LeBoeuf LLP, the Vice Chair of the M&A Committee, and Richard Climan of Dewey & LeBoeuf LLP, a former Chair of the M&A Committee, each of whom served as Special Advisor to the 2009 Study. Both Keith and Rick provided substantial input, leadership and assistance on this project.¹

As we do every time we discuss the results of one of our deal point studies, let me start with a few preliminary comments. First, the findings in the 2009 Study do not necessarily reflect the views of the members of the M&A Committee, the Market Trends Subcommittee, the 2009 Study’s Working Group, or their respective firms. Second, the findings in the 2009 Study do not necessarily reflect my own views. Finally, the 2009 Study reflects various trends and deal points that may not necessarily be applicable to a particular transaction under

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¹ The contents of this article have been adapted to enhance readability and for the purpose of XML output.
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2009 M&A Deal Point Study: Strategic Buyer/Public Targets

Presenting the 2009 Strategic Buyer/Public Target Deal Point Study published by the M&A Market Trends Subcommittee of the M&A Committee of the American Bar Association’s Business Law Section. The study tracks commonly negotiated deal points in acquisition agreements by strategic buyers involving public company targets that were entered into in 2008.

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An Unpredictable Year

Our year-end issue finds us at the close of a strange and tumultuous period, a year that began with the M&A market almost shuttered due to the economic convulsions then occurring, and one that ends with both signs of recovery and remaining questions as to the sector’s long-term health.

In 2008, global M&A had posted its worst performance in years, marked by a striking 44% collapse in merger volume during the fourth quarter, and some predicted at year’s end that 2009 would be a wasteland. That thankfully didn’t happen, with merger volume driven at first by a spate of pharmaceutical mergers (Pfizer/Wyeth, Merck/Schering-Plough) and lately by several large-ticket deals announced in November, including Stanley Works’ $3.5 billion acquisition of Black and Decker and Berkshire Hathaway’s $26 billion purchase of the railroad company Burlington Northern Santa Fe.

But much uncertainty remains, including concerns about the inability for some buyers to find adequate deal financing as well as the market uncertainty due to the widespread belief that the Obama Administration will focus on more aggressive antitrust enforcement. As Jones Day’s Phillip Proger, Bruce McDonald and David Wales write in their early analysis of the administration’s merger review, both the FTC and the Department of Justice show unmistakable signs of more vigorous merger enforcement and a greater willingness to litigate, even on smaller deals, and note that the worldwide economic downturn will not temper antitrust enforcement.

That said, the authors note early speculation that the FTC and the DOJ would chill M&A volume looks increasingly misguided. “Proving wrong some early critics who predicted no merger of any consequence had a snowball’s chance in this Administration, both agencies have continued to allow mergers that likely would survive a court challenge,” the authors write. “Despite statements of aggressive intention, both DOJ and FTC have shown restraint and that they can consider each merger on its facts, even those that appear to involve close calls or were subject to vocal opposition.”

This issue also includes a popular M&A Lawyer annual feature: the latest Strategic Buyer/Public Company Target Deal Point Survey, written by James Griffin of Fulbright and Jaworski. (Griffin wrote the 2007 Study article as well, which ran in the January 2009 issue of The M&A Lawyer.) It’s a more extensive survey than ever before with several new deal points added, including the target’s “compliance with law” representation, the target’s “operating covenant,” the target’s “compliance with covenants” closing condition and a series of new remedy provisions, including whether the deal agreement expressly provided the target the ability to seek the lost deal premium on behalf of the target’s stockholders.

The 2008 study shows an M&A sector, facing a collapse in volume, quickly embracing heightened buyer protections. For example, not a single deal surveyed in the 2008 study featured a “go shop” provision enabling a target board to actively solicit third-party bids, while 97% of public deals surveyed last year contained a “match right” provision enabling original buyers to match any third-party bids.

This is the final issue of 2009 for The M&A Lawyer. I’d like to thank our readers and contributors for making it a rewarding and interesting year, and I wish all of you a happy holiday season and a prosperous New Year. Our next issue, which will include our extensive year-end summary, will appear in January 2010.

CHRIS O’LEARY
MANAGING EDITOR
consideration. As our friends in Delaware like to remind us, “context matters.” Accordingly, be careful in citing the studies for a particular viewpoint (particularly back to the authors, who have the benefit of the underlying data).

Overview
This article provides a brief summary of the results from a few of the deal points we examined in the 2009 Study. In preparing the 2009 Study, the 2009 Study’s Working Group analyzed 103 acquisition agreements for acquisitions of U.S. publicly traded companies by publicly traded and other strategic buyers that were entered into in 2008. As stated above, the 2009 Study excluded transactions involving private equity buyers. All of the transactions studied involved transaction values in excess of $100 million. For deal points examined in our previous Strategic Buyer/Public Target studies, the 2009 Study also compares the results of our analysis to data points tested in those previous studies.

For the 2009 Study, we continued to examine many of the deal points we examined in our earlier studies, including material adverse change provisions, certain representations and warranties, certain closing conditions, termination rights, break-up fee triggers and certain remedies. We also added some new deal points in the 2009 study, including:
- the target’s “compliance with law” representation;
- the target’s “operating covenant;”
- the target’s “compliance with covenants” closing condition; and
- various new remedy provisions, including whether the transaction contained a “reverse termination fee” in the event of a financing failure, whether the agreement expressly provided the target the ability to seek the lost deal premium on behalf of the target’s stockholders, and whether the parties contractually defined the words “willful, knowing and intentional.”

The MAC Condition and Carveouts to the MAC Definition
A number of the deal points we examined relate to the “Material Adverse Change” definition, commonly referred to as the MAC. In general, the concept of a MAC arises in a number of areas in a public company acquisition agreement, including:
- as a qualification to specific representations and warranties;
- as the materiality standard with respect to the “accuracy of representations” closing condition;
- as part of the “absence of changes” representation—which, if brought down to closing, serves as a “back door” closing condition (i.e., the so-called “back door MAC”);
- as a separate closing condition (i.e., “no material adverse change shall have occurred”); and,
- in many cases, as a termination right.

The latter three uses of MAC described above, which function as a “MAC walk right,” provide that in the event that the target has suffered a defined material adverse change, the buyer is not obligated to close and can terminate the transaction without liability (either immediately, or at the outside date). The 2009 Study continued our tradition of examining whether a MAC walk right was included. Consistent with our prior studies and as you would expect, not much changed on this front—97% of the deals studied contained such a provision.

We also continued our tradition of testing the frequency that certain exceptions, or “carveouts,” to the MAC definition appear. Of course, a target often seeks these carveouts to the MAC definition in an effort to minimize conditionality and maximize certainty of closing. Under this approach, the target seeks to limit the MAC definition by specifying certain events that, no matter the consequences thereof, will not constitute a MAC or be taken into account in determining whether a MAC has occurred. Accordingly, if such an event does happen, that event, by itself, will not give the buyer a right to walk from the transaction, although the value of the target may have been substantially reduced.

As you may remember from our 2008 Study, the more commonly negotiated carveouts appeared in a higher percentage of deals in 2007 than appeared in deals analyzed for our previous studies, including carveouts for changes in the “general economy” and the target’s “industry.” In my article for The M&A Lawyer in January 2009 discussing these results, I asked the question whether the 2009 Study would show buyers more successful in resisting these carveouts.2

So were buyers more successful in limiting these “MAC carveouts” in 2008? Not according to what we found in the 2009 Study. While the appearance of a few of the carveouts showed a slight percentage decrease from those of our previous studies, overall the frequency in which these carveouts appeared remained relatively stable, and, in some cases, actually increased.
**MAC/MAE Carveouts (General Economy)**

- Includes Carveout 98% (99% in deals in 2007) (93% in deals in 2005/2006)
- No Carveout 2% (1% in deals in 2007) (7% in deals in 2005/2006)

*Approximately 47% of the transactions in 2008 that required a “disproportionate” impact to be taken into account required such impact to be “material,” “substantial” or similar language.*

**MAC/MAE Carveouts (Industry)**

- Includes Carveout 93% (96% in deals in 2007) (76% in deals in 2005/2006)
- No Carveout 7% (4% in deals in 2007) (24% in deals in 2005/2006)

*Approximately 53% of the transactions in 2008 requiring a “disproportionate” impact to be taken into account required such impact to be “material,” “substantial” or similar language.*
Most notable to us is the frequency in which the carveout for changes resulting from the “announcement or pendency of the Agreement” continued to appear—93% of the transactions surveyed continued to contain this carveout.

So, what do we make of these “carveout” statistics in arguably a more buyer-favorable environment? Perhaps given the difficult burden imposed on buyers in asserting a MAC under applicable case law (in some cases, even when the MAC does not contain any carveouts), are buyers focusing their negotiating time (and leverage) on provisions other than the MAC clause? We did note in at least one transaction in 2008 the target disclosed in its proxy statement seeking approval of the transaction that the buyer ultimately traded away the inclusion of a MAC walk right in the negotiations for more buyer-favorable deal protections. While that is only one example, the substantial hurdles under existing case law for a buyer to successfully establish the occurrence of a target material adverse effect remains an issue for buyers. It will be interesting to see if these clauses develop to provide more specificity surrounding specific events that contractually constitute a “material adverse change” in an effort to provide more protection to buyers (particularly in a more buyer-favorable environment).

Deal Protections—Fiduciary Exception to the Board Recommendation Covenant

As a result of the statutory requirement in Delaware (with similar requirements in other jurisdictions) that a merger must first be approved by the target’s board of directors, initially recommended by the target board to the stockholders for adoption, and then adopted by the stockholders at a duly called stockholders’ meeting, virtually all U.S. public company agreements providing for a merger contain a requirement that the target board call a
special meeting to submit the merger agreement for approval of the target’s stockholders. One deal protection measure often sought by buyers is a contractual covenant that the target board continues to “recommend” the adoption of the merger agreement to its stockholders, as well as a contractual prohibition on the target board from “changing its recommendation” prior to the target’s stockholder meeting. Target counsel often seeks to include a “fiduciary exception” to this board recommendation covenant, which would permit the board to withdraw or modify its recommendation if its fiduciary duties to the target’s stockholders require it to do so. While buyer’s counsel may agree to grant the target board some relief in this context, in many cases buyers seek to limit the target board’s ability to change its recommendation to certain events (such as the receipt of a superior offer).

For those who have followed our deal point studies and the related articles in past issues of The M&A Lawyer, you are no doubt familiar with our continuing discussions surrounding whether the acquisition agreement may permissibly limit the target board’s ability to change its recommendation solely to circumstances in which the target board has received a superior offer. Counsel for targets often argue that the target board needs the ability to change its recommendation even outside of the superior offer context, due to the board’s fiduciary obligation of candor to the target’s stockholders. In doing so, target counsel may reference the Delaware Court of Chancery’s decision in Frontier Oil Corp. v. Holly Corp., as support for the proposition that prohibiting the board from changing its recommendation is an impermissible intrusion on the board’s fiduciary obligations to the target’s stockholders.

Many M&A lawyers are familiar with the argument from buyer’s counsel in this context to the effect that a target board should not be free to just “change its mind” after signing the agreement—and permitting the target board to do so would grant the target board an “easy out” with respect to the transaction. In an effort to balance a buyer’s concerns over a target board’s perceived “free reign” to “change its mind and exit the transaction” and a target board’s concerns over being put in a position of having to either violate its fiduciary duty of candor or breach the acquisition agreement, some compromise provisions have appeared in public company acquisition agreements that permit a target board to change its recommendation in more than merely the superior offer context, but not without limitation. Specifically, these provisions permit the target board to change its recommendation in the context of either a superior offer or an “intervening event”—in essence, a material development or change in circumstances that occurs after the agreement is entered into (and, in many cases, was not known by the target board at the time of the execution of the agreement).

As many of you may recall from our 2008 Study, 48% of the transactions surveyed in that study continued to limit the target’s ability to change its recommendation solely to circumstances in which the target board had received a superior offer (which was consistent with the statistics in our 2007 Study). Furthermore, only 7% of the transactions surveyed in our 2008 Study included an intervening event concept.

In the 2009 Study, we tested for some additional data surrounding this issue. Specifically, we noted that some agreements contained specific language limiting the target board’s ability to change its recommendation solely to the receipt of a superior proposal or an intervening event, but contained further language in the provision that arguably permitted the target board to change its recommendation notwithstanding the specific limitation. This language, which we refer to as a “back door fiduciary exception” to the target board recommendation provision, generally provided that “notwithstanding the foregoing, nothing in this section will prohibit the target board from taking any action necessary to comply with its fiduciary duties under applicable law.”

So what did we find? Based on the results of the 2009 Study, the marketplace appears to be moving on this data point. In the 2009 Study, only 23% of the agreements surveyed limited the target board’s ability to change its recommendation solely to situations involving only a superior offer. Importantly, 55% of the agreements studied provided the target board the specific ability to change its recommendation if its fiduciary duties required it to do so. In addition, an additional 8% of the agreements studied contained the “back door fiduciary exception” (arguably increasing the “fiduciary duties required” statistic to 63% of the agreements studied). We did see an increase in the “limited to superior offer or intervening event” language—up to 13% from 6% in the 2008 Study.
Deal Protections—No Shop and the Buyer’s Match Right

Nearly all public company acquisition agreements contain a contractual prohibition on the ability of the target to solicit competing bids after the acquisition agreement is signed as well as a restriction on the target’s ability to discuss and negotiate competing bids, even if unsolicited.

Due to fiduciary obligations imposed by applicable law, in many cases the “no-talk” portion of these provisions (i.e., the prohibition on discussions and negotiations) contain a fiduciary exception that permits the target’s board to respond to, discuss and negotiate a potential unsolicited alternative transaction with a third-party bidder (subject to specified requirements). In some situations, the target may further negotiate for a right to terminate the underlying agreement in order to accept a “superior offer” from a third party.

While acknowledging the fiduciary duties imposed on a target’s board by applicable law, over the years counsel for buyers have threaded the needle on these non-solicitation provisions in an effort to obtain the best assurance that the buyer will be successful in closing the transaction that it bargained for and incurred expenses to obtain. To do so, buyers often seek to place some restrictions on the ability of the target board to communicate with third-party bidders. One such restriction sought by buyers surrounds this question—at what point may the target discuss with the third party making a bid the nature of that bid? Does a mere inquiry by a third party provide an avenue for the target board to discuss with the third party a potential bid, or does the bid itself need to be more concrete? Does a mere “acquisition proposal” enable the target board to discuss the bid, or does the bid need to meet some higher standard (such as that constituting a “superior offer”)?

Consistent with our prior studies, we looked at these provisions in the 2009 Study and noted not much of a change in the overall statistics. The parties continue to fall to the more middle ground standard—that the acquisition proposal must be “reasonably expected to result in a superior offer.”
We did test for the first time in the 2009 Study certain data surrounding the definition of “superior offer,” which of course has significant meaning under the non-solicitation provision. Specifically, we tested data surrounding what percentage of stock and assets of the target the acquisition proposal must seek before the target board may be entitled to find that the acquisition proposal could meet the “superior offer” standard. For example, can an acquisition proposal for a division of the target constituting 35% of the combined assets of the target ever be deemed a “superior offer” under a particular acquisition agreement? Or what about a tender offer by a third party for 51% of the target’s outstanding stock at a higher price than the deal price?

What did we find? Overall, under both the “stock” test and the “asset” test, “50% or greater but less than All or Substantially All” appear to carry the day, at least with respect to numerical definitions.
Of course, the opposite of a non-solicitation provision is a provision commonly referred to as the “go-shop.” A “go-shop provision” grants the target board the right, for a specified period of time, to actively solicit third-party bids, negotiate with third parties on an alternative transaction and otherwise seek to obtain a more-favorable transaction (subject to specified limitations). As we have noted in some of our previous studies, these go-shop provisions sometimes appeared in the context of a single party bid (particularly those involving private equity buyers) where the target had not otherwise canvassed the market for other potential suitors in an effort to allow the target board to obtain “reliable evidence to assess the fairness of the bid.” In our 2005-2006 study, we noted no transaction in our 2005-2006 study involving a strategic buyer included such a provision. In the 2008 Study (covering transactions entered into in 2007), we noted that 3% of the agreements included a go-shop provision.

What did we find in our 2009 Study? None of the agreements studied included a go-shop provision.

We also tested again the so-called “match right,” a common provision sought by buyers. A match right is a provision in the acquisition agreement that permits the original buyer the opportunity to match, alter or otherwise improve the original deal in response to a third-party bid. When included, this match right op-
erates as a condition precedent to the target’s ability to terminate the acquisition agreement to accept a third-party bid. Essentially a match right gives the buyer the “last bite at the apple” to acquire the target.

As we suspected, buyers continue to place considerable importance on the match right—97% of the agreements tested contain an express “match right” in favor of the buyer, up from 93% in the 2008 Study.

Finally, we tested for the first time in the 2009 Study the “match right period” provided for in the match right. Essentially, the match right period is the contractually agreed to time frame in which the target, following notice to the buyer of the required information under the acquisition agreement, is prohibited from exercising its fiduciary (superior offer) termination right—the period in which the buyer has the ability to alter or otherwise amend the transaction without fear of the target terminating the transaction to accept the “topping bid.”

What did we find? Three to five business days appear to be common, with five business days appearing in 39% of the transactions surveyed.
Remedies

One of the developments following the recent litigation arising out of the significant number of broken deals in the last two years is an increased focus by buyers and sellers on contractual remedies. Given that we were seeing much more negotiation surrounding these provisions, we tested a number of these new provisions for the first time in the 2009 Study.

The “Con Ed” Issue

One new data point tested was whether or not the agreement contained language that expressly provided the target company the right or ability to seek or otherwise obtain the deal premium on behalf of the target company’s stockholders in any damage action brought by the target for the buyer’s breach of the agreement. As many of you are aware, this issue gained prominence following the Second Circuit Court of Appeals’ decision in the Consolidated Edison case, in which the court found that Northeast Utilities and its shareholders were prohibited from recovering the “lost deal premium” after Consolidated Edison refused to complete the acquisition of Northeast Utilities. This, of course, significantly limited the damages available to Northeast Utilities. Prior to the Second Circuit’s decision, many practitioners anticipated that the “lost premium” (or some measure of shareholder damages) would be part of any damages awarded by a court in an action against a buyer who was shown to have breached an acquisition agreement. Following this decision, we began to see parties negotiating over the inclusion of express language in the agreement specifically providing that ability to the target.

The results in the 2009 Study were a little surprising given the intense discussion the ConEd case engendered in M&A circles—only 17% of the deals surveyed specifically included language to this effect.

Express Target Right to Pursue Damages on Behalf of Stockholders*

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* The data set excludes transactions involving solely stock as consideration, none of which included express language providing the target the right to pursue damages on behalf of the target’s stockholders.

Was this lower percentage as a result of buyers successfully resisting the inclusion of specific language addressing the issue? It will be interesting to see if next year’s study shows any movement on this point.

Reverse Termination Fees for Financing Failure

Over the past few years there has been significant discussion concerning the dichotomy in deal structures between a private equity backed acquisition of a public company and those involving a strategic buyer. In particular, a significant portion of these discussions have focused on the effect such structures have on the remedies available to the target company in the event of a breach by the buyer of the acquisition agreement.
As many M&A lawyers are familiar, the typical acquisition of a public company by a *private equity buyer* is generally structured differently than those involving a *strategic buyer*. In general, post-2005 *private equity* backed acquisitions were structured so that the actual buyer under the agreement was a shell company (and not the private equity fund), the acquisition agreement generally denied the right of the target to obtain specific performance of the agreement and, while many agreements did not grant the buyer a “financing out,” the transaction documents did provide that a “reverse termination fee” would be payable by the buyer for failing to close (often as the sole remedy coupled with a limited guarantee of the reverse termination fee by the private equity fund). Contrast that with a *strategic buyer* structure, where the strategic buyer was generally a party to the agreement (and thus “on the hook” for damages for breaches or failure to close), specific performance was often provided for in the agreement, and there was typically no limit on potential damages in the event of a breach by the buyer.

As I noted in my January 2009 *M&A Lawyer* article,\(^1\) we noted that a few strategic transactions entered into in 2008 contained provisions consistent with a “private equity” deal—a reverse termination fee paid in certain events and a cap on damages. We tested for those provisions in the 2009 Study and found some interesting results.

In particular, given the upheaval in the financing markets in 2008, we wondered how often *strategic buyers* would negotiate protections more commonly found in *private equity* backed acquisitions as it related to financing risk. Specifically, we looked at how often *strategic buyers* were successful in limiting their liability exposure for failing to close a transaction due to a financing failure by virtue of the use of a reverse termination fee in these circumstances. To test this data, we identified transactions involving cash as consideration in which financing was at issue—where the acquisition agreement contained a representation from the buyer with respect to commitment letters (or similar obligations) for obtaining financing, or by the inclusion of covenants requiring the buyer to utilize specified efforts to obtain referenced financing between signing and closing.

When looking at this subset of transactions, we noted that 35% of the transactions surveyed involving *strategic buyers* included the reverse termination fee concept for the buyer’s inability to obtain financing, and all of those transactions capped the damages resulting from such failure at the reverse termination fee amount.\(^1\)

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\(^*\) Subset of transactions in which cash was included as consideration and where the buyer contemplated obtaining financing for the acquisition. For purposes of the data set, transactions which included (i) representations by the buyer regarding commitment letters (or similar obligations) with respect to obtaining financing, or (ii) covenants on behalf of the buyer to use specified efforts to obtain referenced financing prior to closing were deemed transactions where the buyer contemplated obtaining financing for the acquisition. Transactions that contained buyer representations generally providing that buyer would have “funds available at closing” were deemed transactions where the buyer contemplated obtaining financing for the acquisition. The data set excludes transactions that contained a financing condition in favor of buyer with no fee payable thereunder.

\(^**\) Does not include mere expense reimbursement.

\(^***\) Two of the eight transactions specifically exclude fraud and willful or intentional breaches from the cap.
What do we make of that? In short, strategic buyers needing acquisition financing may have been unwilling (and perhaps, unable) to put the “mother ship” at risk in a difficult financing environment, and utilized their leverage accordingly. It will be interesting to see if this trend continues. We would note that a number of large transactions involving acquisition financing entered into in 2009 have not utilized this structure. It will be interesting to see how strategic buyers navigate this issue going forward.

“Willful, Knowing and Intentional” Defined

Many public company acquisition agreements contain provisions which use the phrases “willful” or “knowing and intentional.” These words and phrases often appear in the termination provision of the agreements addressing survival of breaches and representations and warranties and covenants post-termination, and in some cases, as carve-outs from a liability cap. Many of you will remember the J&J/Guidant decision in 2007, in which the court, in interpreting what the parties meant by the word “willful,” noted that the word is a “notoriously ambiguous word” and cautioned M&A lawyers to consider defining such a word when using it in a contract. Fast forward to the Hexion/Huntsman decision last year, in which former Vice Chancellor Lamb of the Delaware Court of Chancery interpreted the phrase “knowing and intentional” in connection with the litigation surrounding that transaction. So, given the J&J/Guidant court’s admonition and Vice Chancellor Lamb’s interpretation of “knowing and intentional” in Hexion, we wondered how often M&A lawyers were defining the use of those words and phrases in public company transaction documents. What did we find? Not often.

The 2009 Study found that only 1% of the transactions surveyed defined those phrases. In reviewing the underlying statistics, we did note that over 80% of the transactions surveyed utilized those phrases (or similar phrases) in the acquisition agreement, but nonetheless, declined to specifically define what such phrases mean. Perhaps it is because there were “more important” provisions to negotiate, or perhaps it was due to existing case law as to how the definition may be interpreted. Maybe it was in an effort to maintain some ambiguity to preserve legal arguments, or because the import of such a breach was not of significant importance to the transaction under consideration. We did note that in one deal
that defined what the phrase meant, the import of such a breach was very important—the buyer’s liability in the event of a breach of financing representations and covenants was limited unless the target could show a “willful breach.” It will be interesting to see whether or not M&A lawyers seek to provide some contractual clarity around these definitions in future periods.

Availability of the Study

The 2009 Study is available to members of the M&A Committee, without charge, at http://www.abanet.org/dch/committee.cfm?com=CL560003. We anticipate releasing the 2010 Strategic Buyer/Public Target Study in late 2010 analyzing acquisition agreements entered into in 2009. As always, we welcome your comments and suggestions.

NOTES

1. I also want to thank the Chair of the Mergers & Acquisitions Committee, Leigh Walton of Bass Berry & Sims PLC, and the former Co-Chairs of the Market Trends Subcommittee, Wilson Chu of K&L Gates LLP and Larry Glasgow of Gardere Wynne Sewell LLP.


4. See the acquisition of Ikon Office Solutions by Rikoh Company Ltd.


7. Of course, in many transaction agreements additional standards may be required for the target board to determine the acquisition proposal meets the definition of “superior offer” (such as “fully financed,” “reasonably capable of being completed timely” and “more favorable to the target’s stockholders from a financial point of view.”)
8. Many of the agreements studied also included a match right concept with respect to the ability of the target board to change its recommendation.  
11. Some transactions provided exceptions to the liability cap based on fraud and heightened breach standards.  
14. See the acquisition of Foundry Networks by Brocade Communications Systems.  
15. At least one transaction in 2009 has defined “willful breach” in the transaction documentation. See Merck & Co., Inc.’s acquisition of Schering-Plough Corporation.

An Early Look Into Merger Review in the Obama Administration

BY PHILLIP A. PROGER, J. BRUCE MCDONALD AND DAVID P. WALES

Phillip Proger is head of the Jones Day Antitrust Practice and is a member of the Editorial Board of The M&A Lawyer, Bruce McDonald was a Deputy Assistant Attorney General in the Antitrust Division of the U.S. Department of Justice, and David Wales was Director (Acting) of The Bureau of Competition of the Federal Trade Commission. All three are partners in the Washington, D.C. office of Jones Day.

After the election, there was no shortage of comments predicting much more aggressive merger review in the Obama Administration. As always, any meaningful conclusions on how things will change must be based on what the new leadership actually does once on the job. The Federal Trade Commission’s Jon Leibowitz became Chairman in March 2009, and new Assistant Attorney General Christine Varney took her oath in April, in the midst of a business decline and historically low merger filings. Despite this, the new enforcers already look busy. Both agency heads and their new senior leadership have made enough public statements and enforcement decisions to give business and M&A counselors some indication of how merger enforcement will develop going forward. As an extra bonus, we likely will get more insights into the new Administration’s policies soon, given the recent announcement that the FTC and DOJ will hold workshops to consider revising the Horizontal Merger Guidelines, the bible of agency merger review.

FTC: Pedal to the Metal

Since Chairman Leibowitz took over at the FTC a little over six months ago, the agency already has challenged three mergers in court, obtained a consent settlement in four matters, forced the parties to abandon one deal by continuing to investigate, and settled the long-running litigation challenging Whole Foods’ acquisition of Wild Oats. Below is a brief summary of these actions.

The FTC’s three recent merger challenges in court include:

- **CSL Limited acquisition of Talecris Biotherapeutics**—The FTC filed action to block deal involving plasma-derivative protein therapies; parties immediately abandoned the transaction.
- **Carilion acquisition of Virginia outpatient clinics**—The FTC filed administrative complaint seeking to undo $20 million acquisition; shortly thereafter, Carilion agreed to an order requiring the divestiture of the two clinics.
- **Thoratec acquisition of HeartWare International**—The FTC challenged medical device deal; a day later, the parties abandoned the deal.

So far in the Chairman Leibowitz era, the FTC has obtained four merger consent decrees:

- **BASF acquisition of Ciba Holding**—The FTC required BASF to sell assets related to two high-performance pigments used in the automotive and construction industries.
K+S acquisition of Morton International—The FTC required K+S to divest its bulk-deicing salt assets in Maine and Connecticut.

Pfizer’s acquisition of Wyeth—The FTC required Pfizer to divest numerous animal vaccine and pharmaceutical products.

Schering-Plough acquisition of Merck—The FTC required Schering-Plough to divest interest in an animal health joint venture and anti-nausea pharmaceutical product.

Chairman Leibowitz has overseen two other matters worth noting:

Endocare/Galil Medical merger—FTC Commissioners issued conflicting statements after Endocare announced it had abandoned its $16 million merger with Galil because of the agency’s continuing investigation.

Whole Foods/Wild Oats—The FTC announced it had reached a consent order settlement with Whole Foods, bringing to an end the ongoing litigation involving the 2007 acquisition of rival Wild Oats; Whole Foods to divest 32 Wild Oats stores.

DOJ: Just Warming Up?

While Christine Varney’s Antitrust Division has not brought many merger enforcement actions in the last few months, any upswing in merger filings will allow her to demonstrate her public commitment that DOJ will not “sit on the sidelines.”

Three actions at the Division worth noting are:

Sapa Holding’s acquisition of Indalex—Division required Sapa to divest facility that manufactures aluminum sheathing used in coaxial cable.

Settlement of U.S. v. Microsemi Corp.—Division settled 2008 lawsuit seeking to block non-reportable acquisition of certain semiconductor assets from Semicoa Inc.; Microsemi will divest all of the assets it acquired.

AT&T’s acquisition of Centennial—Division required AT&T to divest wireless mobile phone business in eight markets.

Observations

These enforcement decisions, as well as the agencies’ decisions not to take action in other cases, provide some guidance on their future direction.

1. Both agencies intend more vigorous merger enforcement and are willing to litigate. Continuing trends from recent years, new agency management has thus far only challenged mergers involving high market shares, although in relatively small markets or industries. But under new management both agencies have suggested merger review should be more strict.

Christine Varney, beginning with her confirmation hearings and first speeches as AAG, has been talking tough on antitrust enforcement. In her first speech on the job, AAG Varney explained that the Division would “push forward” to explore more controversial areas of merger enforcement, including vertical theories where the parties are not competitors in the same market but rather have a potential supplier-customer relationship or operate in adjacent markets. The Division will have the opportunity to explore some of these theories as it looks at several high-profile deals, including Ticketmaster/Live Nation and Microsoft/Yahoo. Varney has built a team with strong prior government experience, including two deputies with significant litigation experience, Molly Boast and Bill Cavanaugh. The new Antitrust Division likely will need that experience if it tries to push the envelope on merger enforcement.

Chairman Leibowitz too has predicted vigorous merger enforcement in his tenure, and he already has led the FTC on a number of merger challenges, including three in court. This is less a change at the Commission, whose pro-enforcement majority turned up the enforcement dial even under the previous administration. There is no reason to think the Commission will slow down in the months to come.

The FTC and DOJ also have announced that, starting in December, they will together hold a series of public workshops to consider revisions to the Horizontal Merger Guidelines that are used by the agencies to evaluate deals. In her comments on the potential revisions, AAG Varney explained that two reasons for amending the Guidelines are to more accurately describe current agency practice and to capture “advances in research or evolution in best practices.” The first is not all that surprising or controversial, as there is broad consensus that in certain ways the Guidelines no longer mirror agency practice and could use refreshing. But the second may provide an opportunity for this Administration to raise the bar for mergers. This could be accomplished by strengthening the Guidelines’ presumptions that a
merger is anticompetitive or adding new types of evidence that the agencies could use to show a deal is unlawful. Stay tuned.

2. New management is aggressive, but not foolhardy. Proving wrong some early critics who predicted no merger of any consequence had a snowball’s chance in this Administration, both agencies have continued to allow mergers that likely would survive a court challenge. Despite statements of aggressive intention, both DOJ and FTC have shown restraint and that they can consider each merger on its facts, even those that appear to involve close calls or were subject to vocal opposition.

The Division recently closed its investigation of Oracle’s proposed $7 billion acquisition of Sun Microsystems. According to public reports, the Division explored potential vertical theories and considered whether post-acquisition Oracle would raise the price of Sun’s Java product. There were several signs that the Division might continue the investigation, including the high profile of the merger, the fact that the European Commission is closely scrutinizing the deal and the potential for a rematch against Oracle after the failed challenge of the PeopleSoft acquisition in 2004. But just one month after the parties received a second request, the Division closed its investigation. Thus, it appears that the Division will consider its own view of the facts of each case and will close investigations even when there is pressure to do otherwise.

Similarly, the FTC closed its investigation of Arch Coal’s acquisition of Rio Tinto’s Jacobs Ranch mine in Wyoming. According to public reports, the transaction would have increased the already high concentration among mine companies in the Southern Powder River Basin coal-producing region. With an impact on the country’s energy supply and high market shares, the antitrust bar would not have been surprised if the Commission pressed forward with its review of the transaction. The Commission has a history in this market, however, having failed in court to stop Arch Coal from acquiring a mine under very similar facts in 2004. By closing its investigation, the Commission demonstrates that, while it can be aggressive, it will not be foolhardy in challenging transactions where the odds of prevailing in court are low.

3. Worldwide economic distress will not temper antitrust enforcement. Over the last year, a favorite topic at antitrust gatherings has been whether relaxing antitrust rules could help businesses more quickly recover and improve the economic situation. The general conclusion has been, of course, that allowing anticompetitive mergers does not promote healthy markets any more than hindering procompetitive mergers. Predictably, more companies have tried to take advantage of the “failing firm” defense. Although those arguments may have more credibility in the current environment, that does not mean the standards for evaluating mergers will change.

Moreover, the new antitrust enforcers have emphasized the importance of vigorous antitrust enforcement in economic hard times. In her first speech as AAG in May, Christine Varney compared the economic hardship of the 1930s during regulated competitor coordination with the subsequent financial recovery in the 1940s following increased antitrust enforcement, to reinforce the principle that competition and antitrust are good for the economy. “First, there is no adequate substitute for a competitive market, particularly during times of economic distress. Second, vigorous antitrust enforcement must play a significant role in the Government’s response to economic crises to ensure that markets remain competitive.” Her statements should end speculation that the economic downturn will slow merger enforcement. It will not.

4. Enforcers have more time for small deals and consummated deals. In the weak economy of the last year, most businesses have refrained from new transactions, and the count of Hart-Scott-Rodino Act filings has fallen to new lows. Like the industries they oversee, the antitrust agencies have excess capacity, some of which has been applied to investigations that in busier times would not have gotten much attention. The DOJ, and more so the FTC, have increased their focus on smaller mergers below the HSR filing thresholds and on consummated transactions. The FTC’s recent challenge to Carilion’s acquisition of two small medical clinics in Roanoke and its investigation of the proposed Endocare/Galil merger highlight this trend. Both were well below the $65.2 million HSR threshold, and the Carilion deal had already been completed. The DOJ’s lawsuit to block Microsemi’s Semicoa acquisition similarly confirms DOJ’s willingness to challenge non-reportable, previously-consummated transactions.

5. Healthcare and high-tech are targets. Devoting extra enforcement resources to particular industries is back in fashion, and the new leaders have identified markets they think are not showing enough
Chairman Leibowitz has made it clear in speeches and testimony that his number one priority is competition in healthcare, with an even finer emphasis on so-called “reverse payment settlements” involving pharmaceutical patent litigation. This summer’s three FTC merger challenges all involved medical products and services, and the FTC appears to have brought DOJ closer to its side in the pharma debate by way of the Cipro brief filed in the Second Circuit (opposing reverse payment settlements). Similarly, AAG Varney has announced technology industries as one of her chief targets. The Antitrust Division will take the lead in antitrust enforcement in technology industries, as it has begun with investigations of Google, Microsoft, IBM, and technology company hiring practices.

Conclusion

The agency’s enforcement record so far is consistent with the rhetoric, but certainly does not reflect the sea change predicted by some. But the transactions considered by the new team have been fewer in number and those challenged have been relatively small. It remains to be seen how the agencies will treat more significant mergers and acquisitions that, as economic troubles fade, are presented for antitrust review.

Delaware Court Applies Entire Fairness Standard of Review to a Sale to a Third Party When the Company Has a Controlling Shareholder

BY DAVID J. BERGER, LAWRENCE CHU, AND NEELA MORRISON

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The Delaware Court of Chancery recently issued an interesting opinion that provides additional guidance for structuring transactions to acquire companies with controlling stockholders. In a case arising out of the sale of John Q. Hammons Hotels, Inc. (JQH), the court held that while the stringent entire fairness standard of review generally does not apply to companies with a controlling stockholder if the controlling stockholder was not on both sides of the transaction, the entire fairness standard may apply when the controlling stockholder and the minority stockholders are competing for the merger consideration. Because in this case the controlling stockholder was, in a sense, competing with the minority over how the merger consideration would be divided, the court held that the transaction must be, at a minimum, “(1) recommended by a disinterested and independent special committee, and (2) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders.” While the plaintiffs conceded that the special committee was independent and disinterested, because the majority-of-the-minority condition was waivable and was based only on those voting (and not all minority stockholders), the court held that entire fairness applied (even though the condition was not waived and a majority of all of the minority stockholders did approve the transaction). The decision is significant because, among other reasons, it applies the entire fairness standard to a transaction in which the controlling stockholder did not stand on both sides of the transaction.

Background

This case arose from the common fact pattern of an acquirer proposing to purchase a company that has a controlling stockholder. What was somewhat unusual here was that the controlling stockholder received significant consideration different from that received by the minority stockholders. Here, the controlling stockholder was John Q. Hammons, who held approximately 76 percent of the voting power in JQH. The acquirer was Jonathan Eilian, a third-
party real estate investor with whom, as emphasized by the court, Hammons had no prior relationship and whose offer was neither solicited by Hammons nor JQH.

Eilian approached JQH about a possible transaction in late 2004, when Hammons and a special committee of the JQH board were in the midst of negotiating a sale of the company to another third-party buyer, Barceló Crestline Corp. (Barceló). Over the next several months, Hammons and the special committee negotiated separately with each of Barceló and Eilian. Recognizing the need to obtain Hammons’ consent to any merger, both investors agreed to provide consideration for Hammons’ controlling interest that met his unique requirements, including ownership in the surviving entity for tax purposes and financial resources to continue to develop and manage hotels. The special committee, for its part, recognized its inability to broadly market JQH given Hammons’ transactional veto power, and focused on obtaining the best price reasonably available to minority stockholders in any deal endorsed by Hammons.

Ultimately, the special committee rejected Barceló’s offer of $13 per share for the minority shares, but accepted Eilian’s subsequent, superior offer of $24 per share. Under Eilian’s offer, Hammons received a 2 percent ownership interest in the cash-flow distributions and preferred equity of the surviving entity; a liquidation preference of $335 million associated with his preferred equity interest in the surviving entity; a $25 million short-term and $275 million long-term line of credit for hotel development; ownership of one of JQH’s hotel properties; and various other contractual rights regarding the future development and management of hotels. In essence, Hammons converted his interest in JQH into an opportunity to benefit from any upside achieved by Eilian and to continue in the hotel business himself, without public investors, using assets and contractual rights that had belonged to JQH or had been exchanged for the assets of JQH. The minority stockholders of JQH, on the other hand, simply were cashed out.

In June 2005, the parties entered into a merger agreement that conditioned closing of the merger on approval by the majority of the minority stockholders who voted on the matter, or waiver of that condition by the special committee. In September 2005, the minority stockholders overwhelmingly approved the merger, which closed that month.

In their suit, the plaintiff stockholders alleged various breaches of fiduciary duty by Hammons (by dominating the negotiations and using his position of control to negotiate benefits for himself that were not shared with the minority stockholders) and the JQH directors (by allowing the merger to be negotiated through a deficient process), and contended that the merger was unfair to the minority stockholders, both from a procedural and a substantive standpoint. The primary issue before the court in its ruling on cross-motions for summary judgment was the appropriate standard of judicial review applicable to the transaction.

Court’s Conclusions

Under the Delaware Supreme Court’s decision in Kahn v. Lynch, if a controlling stockholder stands on both sides of an acquisition transaction structured as a merger by acting as both a buyer and seller in the negotiations, the standard of review is entire fairness, under which the party with the evidential burden must prove that the transaction in question was both substantively fair (i.e., a fair price) and procedurally fair (i.e., a fair process that does not coerce the minority stockholders). The adoption of certain procedural protections for minority stockholders can shift the burden of entire fairness review in such mergers from the defendants to the plaintiffs, but cannot reduce the standard of review to the deferential and less stringent business judgment rule, under which courts typically do not second-guess board decisions absent a finding of a breach of the directors’ duty of care or duty of loyalty.

Delaware courts have taken a different approach when the offer to purchase in an acquisition transaction involving a target company with a controlling stockholder is made directly to minority stockholders through a tender offer. In that situation, the transaction can be reviewed under the business judgment rule, subject to the requirements that certain procedural safeguards similar to those required by Kahn v. Lynch are put in place and that the tender offer is not coercive.

Commentators long have noted that Delaware’s differing approach to mergers and tender offers involving conflicted controlling stockholders may lead to substantively similar transactions being subject to different levels of review depending on the deal structure. In more recent Delaware Court of Chan-
cery opinions, the court has advocated for harmony in this area by moving towards the approach taken by the courts in respect of tender offers and adopting the business judgment standard of review for controlling stockholder mergers in which heightened procedural protections for minority stockholders (similar to those in *Kahn v. Lynch*) have been adopted.5

Because the Controlling Stockholder Was Not on Both Sides of the Transaction, *Lynch* Not Applicable

The plaintiffs in this case contended that Hammons stood on both sides of the merger because he would receive an ownership interest in the surviving entity as well as other contractual benefits not available to the minority stockholders, as discussed above. The court rejected this argument, emphasizing the fact that Eilian had negotiated separately with Hammons and with the special committee. Thus, Hammons was not in the position of negotiating on behalf of the minority stockholders, nor was the special committee negotiating directly with Hammons. Rather, the offer made to the minority stockholders came from an unaffiliated third party.

The court also declined the plaintiffs’ invitation to apply the rule of *Kahn v. Lynch* in these factual circumstances and review the merger under an entire fairness standard whether or not Hammons stood on both sides of the transaction. To the contrary, the court held that the business judgment standard may be invoked when the controlling stockholder is not on both sides of the transaction and when the interests of the minority stockholders are adequately protected. Nonetheless, the court held that business judgment review was not automatic outside of the *Kahn v. Lynch* context, instead indicating that because Hammons was essentially competing with the minority stockholders for the portion of the merger consideration to be received, the merger still could be subject to entire fairness review until the defendants overcame the additional hurdle of demonstrating that the interests of the minority stockholders had been protected.

Procedural Protections for Minority Stockholders Were Inadequate

The court recognized that there are two procedural safeguards that can be adopted by a board in an effort to either shift the burden and/or provide for the business judgment standard of review: 1) recommendation by a disinterested and independent committee of the board of directors and 2) approval by stockholders in a non-waivable vote by a majority of all minority stockholders. The court then found that the JQH merger lacked the second safeguard because it was conditioned only on approval by a majority of the minority stockholders who voted, rather than all minority stockholders, and because the need for minority stockholder approval was waivable by the JQH special committee. As a result, the court determined that the merger was subject to entire fairness review.6

Key Takeaways

As Delaware law further evolves with regard to the standards applicable to controlling stockholder transactions, this area will continue to pose potential questions and pitfalls for boards attempting to negotiate and structure a transaction, creating a need to consult with legal advisors early on in any such process. While providing additional guidance in the area, *Hammons* still leaves unclear certain questions. For example, where is the line drawn between a controlling stockholder’s involvement in a negotiating process and its receipt of consideration different from that received by the minority stockholders such that the controlling stockholder competes with the minority for the merger consideration and/or stands on both sides of a transaction? Nevertheless, *Hammons* provides some important practical guidance on these issues, including the following:

- A target board is unlikely to have to prove entire fairness in a transaction that is recommended by a disinterested and independent special committee of the board and that is subject to the non-waivable approval by a majority of all minority stockholders.
- Acquisitions in which a controlling stockholder works with a third-party buyer in a non-dominant manner and in which such third-party buyer negotiates separately with the special committee may be subject to a more favorable standard of review, even when the controlling stockholder will have an ownership interest in the surviving entity. However, parties should be cautious in this area and always seek the advice of counsel, because the types of post-merger relationships between a controlling stockholder...
and a third-party buyer that will trigger Kahn v. Lynch and entire fairness review are extremely fact-specific.

- Adherence to evolving best-practice procedures is crucial to bypassing Delaware’s careful review of transactions involving controlling stockholders and obtaining a more favorable standard of review. Companies should consider an appropriate deal process (as opposed to acting in a reactive manner), and may include in that process having a special committee negotiate with the third-party buyer separate from the controlling stockholder; making sure the special committee has its own legal and financial advisors who are independent and disinterested; and making sure that the committee is appropriately empowered and recognizes its ability to reject an inadequate offer.

- Finally, good disclosure is always a part of good procedure. Appropriate disclosure of potential conflicts of interest among those negotiating on behalf of the minority stockholders, as well as other material information, should be made such that minority stockholders are fully informed of all material information necessary to approve or reject the proposed transaction.

A version of this article originally was published as a Client Alert of Wilson Sonsini Goodrich & Rosati.

NOTES

1. The defendants have filed an application for certification of an interlocutory appeal of the decision.

2. These include situations in which stockholders do not have majority voting control but still hold significant equity stakes in the target company in question. See In re Cysive, Inc. Shareholders Litigation, 836 A.2d 531 (Del. Ch. 2003).


6. Interestingly, the court rejected the defendants’ argument that the business judgment standard was appropriate because a majority of all of the minority stockholders ultimately did approve the merger, noting that a failure to make the safeguards a precondition to a deal deprived them of their “maximum effect.” In addition, the court criticized JQH’s failure to disclose potential conflicts of interest faced by the special committee’s legal and financial advisors.

7. In other words, the court did not explain what facts, such as the presence of a controlling stockholder alone, or Hammons’ continuing interest in the surviving entity, were sufficient to overcome the presumption of business judgment in this case.

Considerations in Voluntarily Filing Notice with the Committee on Foreign Investment in the United States

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Parties to a cross-border transaction must determine whether to voluntarily file notice with the Committee on Foreign Investment in the United States (CFIUS). This article describes (i) the considerations as to whether to file notice, (ii) pre-filing consultation with CFIUS, (iii) the notice and certification, (iv) the CFIUS process where notice is filed and (v) enforcement, in light of the U.S. Treasury Department’s final regulations regarding CFIUS, which became effective in December 2008. These regulations implement Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007, and codify CFIUS process.

Considerations

The parties first need to determine whether (i) there is a covered transaction—whether the transaction (i.e., a proposed or completed merger, acquisition or takeover) is by or with any foreign person (i.e., a foreign national, foreign government or for-
eign entity or an entity over which control is exercised or exercisable thereby) which could result in foreign control of a U.S. business. Control means the “power, direct or indirect, whether or not exercised...to determine, direct, or decide important matters affecting an entity.” Control can be shown by ownership of voting interests, board representation, proxy voting, special shares, contractual arrangements, formal or informal arrangements to act in concert or other means.

The parties also need to determine whether the transaction could present national security considerations. According to U.S. Treasury Department guidance published in December 2008 about the types of transactions CFIUS has reviewed that have presented national security considerations, these transactions have involved U.S. businesses that provide products and services to U.S. Government agencies and state and local authorities and companies that supply goods and services—as prime contractors or subcontractors to prime contractors—to U.S. Government agencies with functions relevant to national security (e.g., information technology, telecommunications, energy, natural resources, industrial products and goods and services that affect the national security-relevant functions of the U.S. Government agency or create vulnerability to sabotage or espionage).

These transactions also have involved U.S. businesses without regard to government contracts, where there are U.S. national security implications (including the energy sector, the nation’s transportation system, U.S. businesses that could significantly and directly affect the U.S. financial system, companies that produce certain types of advanced technologies that may be useful in defending or seeking to impair U.S. national security, U.S. businesses that are engaged in research, development, production or sale of technology, goods, software or services subject to U.S. export controls and where U.S. critical infrastructure is involved (e.g., major energy assets)).

Other situations include whether a transaction is foreign government-controlled and the record of the country of the investor regarding nonproliferation and other national security-related matters. Also, the track record or intentions of the foreign person and its personnel regarding actions that could impair U.S. national security (including the intent to terminate contracts between the U.S. business and U.S. Government agencies for goods and services relevant to national security) have been considered. This guidance is illustrative and does not describe all national security considerations that CFIUS may identify and analyze in reviewing a transaction.

**Pre-Filing Consultation with CFIUS**

Parties are encouraged to consult with CFIUS before filing notice or in connection with filing a draft notice, at least five business days before filing notice.

**Notice and Certification**

If the parties determine to file notice, the notice must, among other things, include information about the transaction, the parties, the expected or actual completion date and a good faith approximation of the net value of the interest acquired in the U.S. business. The parties must provide certifications and certain other documents together with the notice. A final certification needs to be submitted at the conclusion of a review or investigation for each party that has filed additional information after the original notice, at least one or two days before the anticipated closing date of the review or investigation. All information and documentary material filed with CFIUS is afforded confidential treatment.

**CFIUS Process**

After a notice is filed with CFIUS, there is a 30 calendar-day review period. Upon accepting a notice, the Staff Chairperson of CFIUS advises the parties in writing of the start date of the review period. CFIUS examines whether (i) the transaction is by or with any foreign person and could result in foreign control of a U.S. business, (ii) there is credible evidence to support a belief that any foreign person exercising control of that U.S. business might take action that threatens to impair the national security of the U.S. and (iii) provisions of law other than Section 721 of the Defense Production Act of 1950 and the International Emergency Economic Powers Act provide adequate and appropriate authority to protect the national security of the U.S. CFIUS also can review a transaction for which no voluntary notice has been filed, even after completion.

**National Security Risk.** CFIUS identifies all facts and circumstances that have potential national security implications to assess whether the transaction poses national security risk. CFIUS assesses whether
a foreign person has the capability or intent to exploit or cause harm (i.e., whether there is a threat) and whether the nature of the U.S. business or its relationship to a weakness or shortcoming in a system, entity or structure creates susceptibility to impairment of U.S. national security (i.e., whether there is a vulnerability). National security risk is a function of the interaction between threat and vulnerability and the potential consequences of that interaction for U.S. national security.  

Section 721 describes the following factors for CFIUS to consider in assessing whether the transaction poses national security risk: (i) the potential effects of the transaction on the domestic production needed for projected national defense requirements; (ii) the potential effects of the transaction on the capability and capacity of domestic industries to meet national defense requirements (including the availability of human resources, products, technology, materials and other supplies and services); (iii) the potential effects of a foreign person’s control of domestic industries and commercial activity on the capability and capacity of the U.S. to meet the requirements of national security; (iv) the potential national security-related effects on U.S. critical technologies; (v) the potential effects on the long-term projection of U.S. requirements for sources of energy and other critical resources and material; (vi) the potential national security-related effects of the transaction on U.S. critical infrastructure (including major energy assets); (vii) the potential effects of the transaction on the sales of military goods, equipment or technology to countries that present concerns related to terrorism, missile proliferation, chemical, biological or nuclear weapons proliferation or regional military threats; (ix) the potential that the transaction presents for transshipment or diversion of technologies with military applications (including the relevant country’s export control system); (x) whether the transaction could result in the control of a U.S. business by a foreign government or by an entity controlled by or acting on behalf of a foreign government and (xi) the relevant foreign country’s record of adherence to nonproliferation control regimes and record of cooperating with U.S. counterterrorism efforts. CFIUS also may consider other appropriate factors in determining whether a transaction poses national security risk.

No National Security Concerns. If CFIUS concludes that there are no unresolved national security concerns, the transaction may proceed without the possibility of subsequent suspension or prohibition. The U.S. Treasury Department will notify the parties of the CFIUS determination to not to undertake an investigation and to conclude action.

Investigation. CFIUS will undertake an investigation where (i) the transaction threatens to impair U.S. national security and the threat has not been mitigated, (ii) the transaction is a foreign government-controlled transaction, (iii) the transaction would result in control by a foreign person of critical infrastructure that could impair national security and the impairment has not been mitigated or (iv) recommended by a lead agency and CFIUS concurs. The investigation must be completed within 45 days after commencement.

Following the investigation, CFIUS must send a report to the President requesting the President’s decision if: (i) CFIUS recommends that the President suspend or prohibit the transaction; (ii) the members of CFIUS are unable to reach a decision on whether to recommend that the President suspend or prohibit the transaction or (iii) CFIUS requests that the President make a determination regarding the transaction. Otherwise, CFIUS may decide to conclude all action without sending a report to the President and the U.S. Treasury Department will notify the parties in writing of the CFIUS determination to conclude action.

Enforcement

A person that either intentionally or through gross negligence submits a material misstatement or omission in a notice or makes a false certification to CFIUS may be subject to a civil penalty up to $250,000 per violation. A person that either intentionally or through gross negligence violates a material provision of a mitigation agreement with, or a material condition imposed by, the United States may be subject to the greater of (i) a civil penalty up to $250,000 per violation or (ii) the value of the transaction.

NOTES
1. 31 CFR § 800.207; 31 CFR § 800.216; 31 CFR § 800.224.
2. 31 CFR § 800.204.
5. 31 CFR § 800.402(c).
6. 31 CFR § 800.402(c) and (l); 31 CFR § 800.202.
8. 31 CFR § 800.702.
10. 31 CFR § 800.501.
11. 31 CFR § 800.401(c) and § 800.502(b).
14. 31 CFR § 800.601.
15. 31 CFR § 800.504.
16. 31 CFR § 800.503.
17. 31 CFR § 800.506.
18. 31 CFR § 800.801.
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