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GC Agenda

A round-up of major horizon issues for General Counsel

SEPTEMBER 2015

ANTITRUST

BEST PRACTICES FOR MERGER INVESTIGATIONS

The FTC recently updated its best practices for merger investigations to increase the efficiency of merger reviews and underscore the importance of early preparation, after determining that its 2006 reforms did little to reduce the length of merger investigations.

The FTC's updated best practices advise parties to merger investigations to, among other things:

- Volunteer key information not included in the Hart-Scott-Rodino (HSR) filing during the initial waiting period or before the filing is made. Volunteering supplemental information early may avoid the issuance of a burdensome request for additional documents (known as a Second Request).
- Be prepared to provide the FTC with specific documents early in the process, including:
  - recent strategic plans;
  - lists of customers and competitors;
  - organization charts; and
  - maps of how data is stored within the organization.
- Withdraw and refile their HSR filing near the end of the initial review period if there are lingering issues that may be resolved without a Second Request.

Adhering to guidance from the FTC and DOJ is important to efficiently getting deals through antitrust review, particularly given the continued high levels of merger enforcement activity. For example, in recent months:

- The FTC obtained an injunction in federal court against the Sysco and US Foods merger.
- The DOJ filed a lawsuit to enjoin Electrolux's proposed acquisition of GE's appliance business.
- The FTC required Dollar Tree to divest 330 stores to close its acquisition of Family Dollar.

Search Avoiding, Negotiating and Responding to Second Requests for more on strategies for avoiding or narrowing a Second Request.

CAPITAL MARKETS & CORPORATE GOVERNANCE

DODD-FRANK ACT PAY RATIO DISCLOSURE

Public companies should think about how to calculate their pay ratio following the SEC's adoption of a final rule implementing the pay ratio disclosure provision (Section 953(b)) of the Dodd-Frank Act.

Covered companies must disclose:

- The median of the annual total compensation of all employees, excluding the principal executive officer (PEO).

- The PEO's annual total compensation.
- The ratio of the median employee's annual total compensation to the PEO's annual total compensation.
- Information on the methodology and assumptions, adjustments or estimates used to identify the median employee or to determine total compensation or elements of total compensation.

Companies must begin making pay ratio disclosure for the first fiscal year beginning on or after January 1, 2017. Therefore, calendar year-end companies must make this disclosure for fiscal year 2017 in their Form 10-Ks for 2017 due in 2018 or proxy statements for the 2018 annual meeting. Emerging growth companies, smaller reporting companies and foreign private issuers are not required to make this disclosure.

The final rule differs from the SEC's 2013 proposal in several ways that are more favorable to companies. For example, companies may identify their median employee once every three years instead of annually, unless certain changes occur.

Companies should begin determining whether they have systems in place to collect and process the data necessary to comply with the pay ratio disclosure rule.

CLAWBACK POLICIES

The SEC recently proposed a rule that would require listed companies to adopt and comply with written clawback policies. For more information on the proposed rule, see below *Employee Benefits & Executive Compensation: Clawback Policies*.

DEBT OFFERINGS AND RESTRUCTURINGS

Another holding in a series of decisions by the US District Court for the Southern District of New York may limit the ability of issuers and majority debtholders to conduct non-consensual out-of-court restructurings involving debt securities issued under Trust Indenture Act (TIA)-qualified indentures.

In a June 2015 decision, *Marblegate Asset Management v. Education Management Corporation* (Marblegate II), the court endorsed a broad interpretation of Section 316(b) of the TIA. The court held that a debt restructuring that effectively left dissenting bondholders to recover against a shell issuer violated Section 316(b), even though it did not formally modify any indenture provisions governing their right to receive payment of principal and interest. The terms of the restructuring provided that non-consenting bondholders would receive equity in an entity stripped of assets entirely, while consenting bondholders received interests in the transferee entity.

Marblegate II was a decision on the merits following a December 2014 holding in the same litigation (Marblegate I). In Marblegate I, the court declined to enjoin the restructuring, but found the dissenting bondholders likely to succeed on the merits.

The broad interpretation of Section 316(b) in Marblegate II makes uncertain the legality of certain types of debt restructurings to which the TIA applies. Debt issuers may:

- Consider these cases in deciding whether to issue debt securities on an SEC-registered or, alternatively, permanently private (144A for life) basis. 144A for life debt securities are issued in transactions exempt from SEC registration (and not subject to provisions of the TIA) with the expectation that they will never be resold in SEC-registered transactions.
- Review indentures used in 144A for life issuances and consider modifying provisions that closely track Section 316(b) and may be interpreted similarly in litigation.

Search Methods of Restructuring Outstanding Debt Securities for more on debt restructurings.

COMMERCIAL TRANSACTIONS

FCC DECLARATORY RULING ON THE TCPA

Telemarketing companies should evaluate their practices to ensure compliance with the Telephone Consumer Protection Act of 1991 (TCPA) in light of an expansive and detailed declaratory ruling issued by the Federal Communications Commission (FCC), which became effective on July 10, 2015.

Notably, the FCC ruled on the definition of a prohibited autodialer under the TCPA. In determining whether specific equipment falls within the definition, the ruling states that:

- Equipment can possess the requisite capacity to be an autodialer if it has either the present or potential capability to be an autodialer.
- Case-by-case evaluation is necessary to determine if equipment that requires human intervention qualifies as an autodialer.
- Predictive dialers are autodialers.
- Autodialers can include separately owned pieces of equipment that work in concert.

The FCC also ruled on other TCPA issues, including:

- **Liability for calls made to reassigned or wrong numbers.** A caller is liable for calls made to the current telephone subscriber, regardless of whether the caller intended to call a telephone subscriber from whom it had prior consent.
- **Consent revocation.** Telephone subscribers may revoke their consent to be called at any time and by any reasonable means.

The ruling also exempts from the TCPA's consumer consent requirements certain calls about time-sensitive financial and healthcare issues. These calls are required to both benefit and be free to the called party, among other requirements. To ensure the calls are free, telemarketing companies should first make arrangements with each carrier.

Search Direct Marketing for more on the statutes, regulations and voluntary codes of practice that apply to direct marketing activities.

CORPORATE AND M&A

NEW CHALLENGES TO SHAREHOLDER M&A LITIGATION

Several recent Delaware Court of Chancery decisions have taken aim at stemming the tide of shareholder litigation that accompanies the vast majority of public M&A deals.

Two bench rulings rejected settlements of fiduciary duty claims brought in M&A deals that would have granted the defendants global releases:

- In *Acevedo v. Aeroflex Holding Corp.*, the settlement contemplated supplemental disclosures, as well as modifications to the deal protection provisions in the merger agreement, in return for a release by the plaintiffs of all claims relating to the merger and payment of the plaintiffs' attorneys' fees. Acknowledging a split with the court's own custom, Vice Chancellor Laster rejected the settlement. He explained that the practice of trading "intergalactic releases" for modifications that do not add value for the shareholders had gotten out of control and was no longer worth the trade-off for quickly settling shareholder lawsuits.
- In *In re InterMune, Inc. Stockholder Litigation*, Vice Chancellor Noble expressed his reluctance to continue approving similar settlements, commenting that he felt like a "deal insurance" salesman.

The court's new, stricter approach has already been raised in two other M&A settlement proceedings.

Two recent decisions have also made the practice of post-signing appraisal arbitrage less likely to be profitable:

- In *LongPath Capital, LLC v. Ramtron International Corp.*, the court held that the negotiated merger price was an accurate representation of the value of the shares, even though the transaction had begun as a hostile takeover attempt.
- In *In re Appraisal of Dell Inc.*, the court held that if a beneficial owner's broker or custodial bank re-titles the shares' physical stock certificates, the chain of continuous record ownership is considered broken and the beneficial owner loses its right to seek appraisal.

The *Ramtron* and *Dell* decisions provide companies defending their deals against appraisal arbitrageurs with new ways to win, either by obtaining outright dismissal or by securing a ruling that awards dissenting shareholders nothing more than the previously negotiated merger price.

EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION

CLAWBACK POLICIES

The SEC has proposed a rule to implement the clawback requirements of the Dodd-Frank Act. Companies should be aware that proposed Rule 10D-1 under the Exchange Act would direct the national securities exchanges to establish listing standards requiring listed companies to adopt and comply with written clawback policies.

Under Rule 10D-1, clawback policies would be required to provide for the recovery of excess incentive-based compensation earned by current and former executive officers during a three-year look-back period preceding the date the company is required to prepare an accounting restatement due to material noncompliance with financial reporting requirements. The definition of "executive officer" in Rule 10D-1 is modeled on the definition of "officer" in Section 16 of the Exchange Act.

Almost all listed companies would be subject to Rule 10D-1 and any listing standards, including:

- Foreign private issuers.
- Smaller reporting companies.
- Emerging growth companies.
- Controlled companies.

Rule 10D-1 would also require listed companies to:

- Disclose information about the implementation of their clawback policy.
- File a copy of their clawback policy as an exhibit to their annual report.

After the SEC finalizes Rule 10D-1:

- The securities exchanges would have 90 days from the date the final rule is published in the Federal Register to propose appropriate listing standards, which must become effective no later than one year after the final rule's publication.
- Each listed company would have 60 days after the relevant listing standard becomes effective to adopt a compliant clawback policy.

The clawback requirement applies to excess incentive-based compensation received on or after the effective date of Rule 10D-1 (even if the securities exchanges have not yet adopted listing standards) if the compensation results from achieving a financial reporting measure based on financial information for any fiscal period ending on or after the effective date.

Companies should:

- Review their clawback policies and consider what changes would need to be made.
- Consider which elements of their compensation program qualify as incentive-based compensation.
- Determine which individuals are executive officers that must be covered under the clawback policy.

Search Clawback Policy for a sample clawback policy.

LUMP-SUM WINDOWS

The Treasury Department and IRS recently issued Notice 2015-49 under which sponsors of defined benefit pension plans are prohibited from implementing lump-sum risk transferring programs or "lump-sum windows" to retirees who have commenced annuity payments.

Employers often limit the risk of pension plan liabilities by offering a one-time lump-sum cash-out opportunity to terminated vested participants or retirees. Lump-sum windows permit a vested participant or retiree to convert the remaining value of his annuity to a lump-sum payment. By reducing the number of participants entitled to benefits from the pension plan, lump-sum windows can help eliminate future pension payments from the plan sponsor's balance sheet.

Pursuant to Notice 2015-49, the IRS intends to amend the required minimum distribution (RMD) regulations under Internal Revenue Code Section 401(a)(9) to provide that pension plans may not accelerate annuity payments that have commenced with lump-sum distributions. The RMD rules generally provide for only limited circumstances when benefits payments may be accelerated. The proposed amendments in Notice 2015-49 are effective as of July 9, 2015. However, Notice 2015-49 contains certain exceptions, including for certain lump-sum windows adopted before July 9, 2015.

An employer that sponsors a pension plan that intends to provide for a lump-sum window must now limit eligibility to participants who have not commenced benefits payments.

Search IRS Notice 2015-49 Prohibits Plans from Offering Lump-sum Risk Transferring Programs for more on IRS Notice 2015-49.

FINANCE & BANKRUPTCY

RESIDENTIAL MORTGAGE-BACKED SECURITIES LIABILITY

Banks concerned about lingering residential mortgage-backed securities (RMBS) liability should take note of the Court of Appeals of New York's holding that a cause of action for a breach of representations and warranties in a mortgage loan purchase agreement (MLPA) accrues on the MLPA's closing date. Therefore, the obligation to cure or repurchase non-compliant mortgages under the MLPA also runs from the closing date, regardless of when the breaches were discovered.

In *ACE Securities Corp. v. DB Structured Products, Inc.*, DB sold mortgages to ACE, an affiliate securitization depositor, pursuant to an MLPA. ACE then transferred the mortgages to an issuer trust, which issued RMBS. Subsequently, delinquencies in the issuer trust began to mount. Two certificateholders filed a lawsuit (six years to the day after the closing date) claiming that the mortgages breached the representations and warranties made by DB.

On appeal, the Court of Appeals dismissed the complaint, finding that the six-year statute of limitations to enforce the cure and repurchase provision in the MLPA begins to run on the date that the representations and warranties were breached, which was the closing date. This decision demonstrates:

- **The diligence required when entering into a securitization transaction.** If the trustee had reviewed the mortgages that were included in the transaction, it would have found that they were largely non-compliant and it could have exercised its remedies in a timely fashion. Failure to do so resulted in the inability to bring a lawsuit.
- **The dangers of allowing an extended timeframe to cure defects.** Under the cure and repurchase provisions in the MLPA, the trust was required to identify non-compliant mortgages and give notice to DB at least 90 days before the statute of limitations actually expired, simply to preserve the ability to bring a lawsuit in a timely manner.

Search Securitization: US Overview for more on securitizations.

INTELLECTUAL PROPERTY & TECHNOLOGY

DATA BREACH STANDING

Companies should consider their data breach litigation strategy given a Seventh Circuit decision departing from the prevailing view that plaintiffs lack standing when they allege no financial injury and rely instead on allegations of increased risk of future harm.

In *Remijas v. Neiman Marcus Group, LLC*, the district court dismissed plaintiffs' claims that Neiman's data breach exposed their credit and debit card information for lack of standing in line with most decisions since the US Supreme Court's *Clapper v. Amnesty International* decision. The Seventh Circuit reversed, holding that the plaintiffs had alleged sufficient injury based on:

- Aggravation and loss of time resulting from fraudulent charges.
- A plausible risk of future harm.

The Seventh Circuit distinguished *Clapper*, noting that:

- In *Neiman*, the plaintiffs' information was actually accessed.
- Neiman's offer of free credit monitoring and identity theft protection suggested that the data breach put the plaintiffs at substantial risk of harm.

The Seventh Circuit also held that Neiman's admission of the breach and notice to customers were admissions sufficient to prove causation.

This decision is the first appellate court decision on data breach standing since *Clapper* and will pose a significant hurdle to standing motions. Counsel should be aware that cases are more likely to be resolved on Federal Rule of Civil Procedure (FRCP) 12(b)(6) motions or at the summary judgment or class certification stages, all of which weigh in favor of early settlement.

Search Seventh Circuit Holds Neiman Marcus Data Breach Plaintiffs Have Standing for more on this decision.

LABOR & EMPLOYMENT

INDEPENDENT CONTRACTOR MISCLASSIFICATION

Companies should review their independent contractor relationships in light of the Department of Labor's (DOL's) recent guidance on the economic realities test for identifying misclassified workers.

Administrator's Interpretation No. 2015-1 (guidance) clarifies the factors for determining if a worker is economically dependent on the company or in business for himself under the Fair Labor

Standards Act (FLSA). The guidance takes the aggressive position that most workers are employees under the FLSA and states that a true independent contractor typically:

- Does not perform work integral to the company's business.
- Exercises managerial skills that affect his profit or loss.
- Makes significant investments in his business beyond tools and comparable to the company's investments.
- Possesses business skills and judgment beyond technical skills.
- Does not work continuously for the company, unless a permanent or an indefinite relationship results from the worker's business initiative.
- Exercises meaningful control over the work.

The guidance rejects the argument commonly made by companies that control over the worker is necessary due to the nature of the business or regulatory requirements.

Courts may vary in the level of deference afforded to the guidance, but companies should:

- Conduct a privileged audit of their workforce.
- Consider strategies for minimizing exposure from misclassification, including class action waivers in arbitration agreements.
- Evaluate alternatives to reclassification, such as modifying the nature of the relationship.

Written independent contractor agreements are a good practice, although they are not determinative. These agreements should:

- Be individually tailored and accurately describe the relationship.
- Include terms that reflect the economic realities test.
- Avoid boilerplate language and other red flags, such as non-compete provisions.
- Be followed in practice.
- Include strong indemnification language, if contracting with a company that employs the worker.

Search Independent Contractor Classification for more on independent contractor classification, including the benefits of the classification and the penalties for misclassification.

LITIGATION & ADR

SIGNIFICANT CHANGES TO THE SCOPE OF DISCOVERY

Proposed amendments to FRCP 26(b)(1) will offer parties an opportunity to significantly reduce the costs and burdens associated with discovery in complex civil litigation.

The proposed amendments, which are widely expected to become effective on December 1, 2015, will significantly impact discovery practice by, among other things:

- Eliminating the longstanding provision that information "reasonably calculated to lead to the discovery of admissible evidence" may be discovered.
- Permitting discovery regarding any non-privileged matter that is relevant to any party's claim or defense, only if proportional to the needs of the case based on:
  - the importance of the issues at stake in the action;
  - the amount in controversy;
  - the parties' relative access to relevant information;
  - the parties' resources;
  - the importance of the proposed discovery in resolving the issues; and
  - whether the burden or expense of the proposed discovery outweighs its likely benefit.
- Deleting language permitting discovery of information "relevant to the subject matter" for good cause, and instead allowing discovery on the claims and defenses identified in the pleadings.

Active judicial case management and better cooperation among the parties can help ensure that these new limits on the scope of discovery are properly applied. To effectively reduce the costs and burdens of discovery under the proposed amendments, parties should consider:

- Addressing proportionality concerns with opposing counsel well before the start of discovery.
- Using early data assessment technology to identify relevant electronically stored information (ESI), gather information and build knowledge before discovery begins.
- Conducting discovery in phases, with an early focus on only the most important documents, data sources, custodians, dates and search terms.
- Using technology-assisted review tools, including predictive coding, to help minimize the burden of cases with large volumes of ESI.
- Streamlining the privilege review process, by reducing the categories of documents to be reviewed and using categorical designations of privileged documents.

Search E-Discovery in the US for more on key issues related to the production of ESI in litigation.

ASSERTING THE RIGHT TO ARBITRATE

A Tenth Circuit decision reminds companies that are sued in court on claims that may be covered by an arbitration agreement not to delay in asserting their right to arbitrate.

In *Healy v. Cox Communications, Inc.*, the Tenth Circuit affirmed the district court's decision denying Cox's motion to compel individual arbitration of antitrust claims by a class of Oklahoma cable television subscribers, holding that Cox's failure to mention its right to arbitrate until after class certification "manipulat[ed] the litigation machinery" and constituted waiver.

Cox began inserting arbitration clauses into its subscribers' contracts in 2009, while facing antitrust claims by a putative nationwide class of subscribers. In 2012, after the court denied certification of the nationwide class, the plaintiffs launched new

WEBINAR

KEY ISSUES IN STARTUP AND TECHNOLOGY COMPANY LEASES

For more on tenant estoppel certificates and other commercial leasing issues for startups and technology companies, join Practical Law Real Estate and *Hans Lapping* of *Miller Starr Regalia* for a free webinar on September 29, 2015.

To register, go to practicallawwebinars.com.

lawsuits with classes for specific geographic regions. Without mentioning its right to arbitrate, Cox unsuccessfully moved to dismiss the Oklahoma case. For the next two years, Cox never mentioned its arbitration right as the parties conducted extensive discovery and litigated class certification. After the class was certified, Cox moved to compel arbitration.

The Tenth Circuit agreed with the district court that Cox's motion to compel arbitration, which would have removed 87% of the class, would have had a material impact on the district court's numerosity analysis for class certification. Rejecting Cox's contention that it could not move to compel arbitration by absent class members until after certification, the Tenth Circuit noted that Cox could have raised an arbitration defense or informed the court of its arbitration right earlier. Admonishing Cox for its "cynical" attempt to "game the federal courts" and play "heads I win, tails you lose," the Tenth Circuit concluded that Cox's conduct was inconsistent with an intent to arbitrate.

This case underscores that even though courts generally favor arbitration, they do not tolerate gamesmanship and will reject eleventh hour efforts to compel arbitration that could have been raised earlier.

Search Class Arbitration Waivers in the US: Case Tracker for recent developments in class arbitration waivers.

REAL ESTATE

TENANT ESTOPPEL CERTIFICATES

As more landlords seek to capitalize on the recovering real estate markets by selling their properties, tenants are increasingly likely to receive requests for tenant estoppel certificates. Overlooking the importance of estoppel certificates and approving inaccurate information can bind a tenant to inaccurate, and potentially harmful, terms in future dealings with its new landlord.

An estoppel certificate is a tenant's certification of certain material terms of its lease. Many tenants fail to carefully review estoppel certificates and instead, merely execute and return them to their landlords. Most courts hold that the contents of an estoppel certificate are binding even if the lease contains contrary facts.

Given their importance, tenants should implement policies for the delivery of estoppel certificates. Tenants should:

- Review all lease-related documents on the receipt of a request to execute an estoppel certificate to determine:
  - when the estoppel certificate must be delivered;
  - the penalties for failing to timely respond; and
  - if the requested certifications in the estoppel certificate are required under the lease.
- Ensure that the requested certifications are correct and contact the landlord immediately if there are any inaccuracies.
- Attach a complete copy of the lease (including all amendments) to the estoppel certificate once it is approved.
- Keep a copy of all executed estoppel certificates with the permanent lease file.

Search Tenant Estoppel Certificate for a sample estoppel certificate drafted from the lender's perspective in the context of a landlord's financing of the underlying commercial property. This estoppel certificate can be modified to apply in the context of a sale of the property.

Search Closing the Purchase and Sale of Commercial Real Estate for more on seller deliverables in a commercial real estate purchase and sale transaction.

TAXATION

MANAGEMENT FEE WAIVERS

The IRS and Treasury Department recently issued proposed regulations and announced a change to the safe harbor of Revenue Procedure 93-27, which may discourage fund managers from waiving management fees or structuring new management fee waivers.

The proposed regulations provide for when a share of partnership income and distributions is treated as a disguised payment for services. They address management fee waivers used primarily in the private equity fund industry to convert ordinary fee income into an interest in future fund profits. Under the proposed regulations, the determination of whether an arrangement is a payment for services is based on all the facts and circumstances. The proposed regulations include a non-exclusive list of six relevant factors, the most important of which is whether the allocation and distribution is subject to significant entrepreneurial risk.

The IRS and Treasury Department also announced their intention to provide an additional exception to the safe harbor in Revenue Procedure 93-27 (applicable to the receipt of a profits interest), which taxpayers have generally relied on to take the position that the receipt of a profits interest in exchange for waiving management fees is not a taxable event. The additional exception will apply to a profits interest issued in conjunction with a partner waiving payment of an amount that is substantially fixed (including a typical fund management fee) for the performance of services. As a result, the issuance of profits interests in exchange for many common types of management fee waivers may be subject to potential valuation issues.

The proposed regulations would be effective for arrangements entered into or modified after the issuance of final regulations. To the extent an arrangement permits a service provider to waive all or a portion of its fees for any period after the arrangement is created, the arrangement is considered to be modified for purposes of the effective date on the date or dates the fee is waived.

GC Agenda Interviewees

GC Agenda is based on interviews with Advisory Board members and leading experts from Law Department Panel Firms. Practical Law would like to thank the following experts for participating in interviews for this month's issue:

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