Hogan Lovells

HIGHLIGHTS OF MAJOR PROVISIONS OF NEW FOOD SAFETY LEGISLATION

1. <u>New responsibilities on food manufacturers and food producers:</u>

- **Hazard analysis and identification of preventive controls**
  - -- Each registered facility will be required to conduct a hazard analysis of reasonably foreseeable hazards and put into place preventive controls designed to significantly minimize or prevent those hazards.
  - -- Each registered facility will be required to implement its preventive controls through a system that includes monitoring, corrective actions, and verification that the system is working properly.
  - -- Finished product and environmental testing is considered part of the facility's verification process.

- **Supply chain management**
  - -- Supplier verification activities are expressly listed as one of the preventive controls to be implemented.
  - -- (See also foreign supplier verification program below under Import Controls.)

- **Records maintenance and access**
  - -- Each registered facility will be required to document its hazard analysis and preventive controls system, including corrective actions and product/environmental testing, and to make those records available to FDA upon request.

- **Intentionally introduced hazards**
  - -- Each registered facility will also be required to conduct a hazards analysis of those hazards that may be intentionally introduced, including those introduced by acts of terrorism, and to implement appropriate mitigation steps as deemed necessary by the FDA.

- **Traceability**
  - -- FDA will be required to conduct pilot tests and issue regulations for "high risk" products; the bill contains many restrictions on FDA's authority, including no "full pedigree" requirements and an express exemption for "commingled raw agricultural commodities."

- **Fresh product standards**
  - -- FDA will be required to issue mandatory standards for "high risk" types of fresh fruits and vegetables and update its good agricultural practices covering the remaining product categories.

- **Very small business exemption**
  - -- The bill contains a limited exemption from both the preventive controls provision and from any mandatory produce standards for very small businesses and very small farms, based on limited sales and area of distribution.

2. <u>Tighter controls over imports</u>

- **Foreign supplier verification program**
  - -- Importers will be required to verify that imported food and food ingredients are produced in accordance with U.S. requirements.
  - -- Records must be maintained for two years and be accessible to the FDA.

- **Third party certification**
  - -- FDA has authority to require third party certification for specific types or sources of imported food, based on public health considerations.
  - -- FDA may refuse admission if certification is not provided.
  - -- Third parties may be accredited foreign governments or private auditors.

- **Accreditation process**
  - -- FDA will recognize accrediting bodies which, in turn, are to evaluate and accredit third party auditors.
  - -- FDA will establish standards for accrediting bodies and conflict-of-interest standards for third party auditors.
  - -- Third party auditors will be required to report directly to FDA any conditions that could cause or contribute to a serious risk to the public health.
  - -- False statements made by foreign facilities to third party auditors are subject to criminal penalties.

- **Certified laboratories**
  - -- FDA will be required to recognize accreditation bodies to accredit laboratories, including laboratories administered by a Federal agency as well as independent private laboratories.
  - -- Accredited laboratories will be required to be used when FDA has designated an identified or suspected food safety problem.
  - -- Laboratory results will be sent directly to the FDA in addition to the importer.

- **Voluntary qualified importer program**
  - -- FDA will provide for expedited entry (i.e., “fast lane”) for qualified importers who voluntarily participate in the program.
  - -- Eligibility includes third party certification, among other factors.
  - -- FDA will coordinate with Department of Homeland Security, which operates a similar program from the security perspective.
  - -- Participation will be subject to a fee (see below).

3. Stronger FDA enforcement powers

- **More frequent FDA inspections**
  - -- Domestic facilities will be inspected based on risk: high risk facilities at least once every 3 years, and low risk facilities at least once every 5 years.
  - -- Foreign facilities to be inspected with increasing frequency over time: 600 total foreign facility inspections in the first year, to double each year for 5 years, reaching 9,600 foreign facility inspections by 2015.

- **Mandatory recall authority**
  - -- FDA will be given authority to mandate a food product recall if the company refuses to do so voluntarily and the hazard meets the criteria for a Class 1 recall.
  - -- Only the FDA Commissioner has authority to mandate a recall, following an opportunity for an informal hearing.
  - -- A company will face civil money penalties for refusing to conduct a mandatory recall.

- **Suspension of registration**
  - -- FDA will be given authority to suspend a company's registration, thereby revoking its license to operate, when the food presents a reasonable probability of causing serious adverse health consequences or death.
  - -- For a company that only packs, received or holds food, there is the added requirement that the company "knew or should have known" of the problem conditions.
  - -- Only the FDA Commissioner has authority to suspend a company's registration, following an opportunity for an informal hearing.
  - -- The bill provides a process for subsequent reinstatement based on corrective action.

- **Enhanced administrative detention authority**
  - -- Standard for administrative detention of food is broadened to "has reason to believe" the food is "adulterated or misbranded." (Under prior law, detention was limited to where there was "credible evidence" that the food presents a "threat of serious adverse health consequences or death.").
  - -- Administrative detention remains a temporary measure, lasting until the agency institutes a formal seizure action in Federal court.

4. New fees on food facilities

- **Reinspection fees**
  - -- Fees will be assessed to reimburse FDA for reinspection-related costs for domestic facilities and importers.

- **Recall fees**
  - -- Fees will be limited to the reimbursement of FDA for recall-related costs when a company refuses to conduct a mandatory recall.

- **Voluntary qualified importer program fees**
  - -- Fees are intended to reimburse FDA for costs associated with operating a voluntary qualified importer program (i.e., fast lane).

- **Export certificate fees**
  - -- Fees will reimburse FDA for costs associated with providing export certificates to companies that voluntarily request them.
  - -- This fee has long been assessed against exporters of other FDA-regulated products.

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MEMORANDUM

From: Joseph A. Levitt
Elizabeth Barr Fawell
Maile Gradison Hermida

Date: January 5, 2011

Re: **President Obama Signs Food Safety Legislation; Side-by-Side Summary**

Late yesterday, President Barack Obama signed the landmark food safety legislation that Congress passed late last month with bipartisan support. The signing culminates three years of drafting, hearings, and Congressional discussion and debate about the country's food safety system. The new law includes four main areas of focus: (1) new responsibilities for food manufacturers and food producers; (2) tighter controls over imports; (3) stronger FDA enforcement powers; and (4) new fees on food facilities.

To facilitate understanding of the new law, two summary documents are attached to this memorandum. First, attached is side-by-side chart comparing the key provisions of the new law with the previous (current) law. Second, we are providing a 3-page summary highlighting the new law's most significant major provisions. These materials supplement the detailed memorandum and section-by-section analysis of the law that we provided when the legislation was passed by Congress last month. 1/ Additionally, to assist with implementation of the new law, we are preparing a separate memorandum summarizing the law's effective dates and related implementation issues.

* * *

Please let us know if you have any questions or if we can assist you in any way with your implementation of this new landmark legislation.

1/ Hogan Lovells memorandum: Congress Passes Landmark Food Safety Legislation, dated December 21, 2010.

Key Provisions in New Food Safety Legislation (The Durbin Bill) and Current Law

Prepared by Hogan Lovells US LLP
(Last Updated: December 21, 2010)

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Key Provisions in New Food Safety Legislation (TheDurbin Bill) and Current Law

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
Facility Registration	Food facilities, both domestic and foreign, would be required to register with FDA every two years. There would be an “abbreviated registration renewal” for those facilities reporting no changes. FDA would have the authority to adjust food registration categories. FDA would have the authority to require registration in electronic format, but not before 5 years after enactment of the bill. FDA would be required to issue a small entity compliance guide (SECG) within 180 days of enactment. Clarifies that the term "retail food establishment" includes places such as roadside stands and farmers' markets. (Sec. 102)	FFDCA § 415. Requires initial registration of food facilities, both domestic and foreign; requires that registration be updated within 60 days of any change to any of the required information previously submitted; no required re-registration at designated interval.
Unique Facility Identification Number	Within 1 year, FDA would be required to conduct a study on the need for and challenges associated with requiring unique facility identification numbers for each registered food facility and import broker. FDA would be required to submit a report regarding the results of the study within 15 months of enactment. (Sec. 110).	NONE
Preventive Process Controls	Each registered facility would be required to conduct a hazard evaluation to identify “known or reasonably foreseeable hazards,” including “biological, chemical, physical, and radiological hazards, natural toxins, pesticides, drug residues, decomposition, parasites, and unapproved food and color additives,” and “hazards that occur naturally or may be unintentionally introduced” as well as hazards that “may be intentionally introduced, including by acts of terrorism” and implement preventive controls (including at critical control points, if any) to provide assurances that the identified hazards would be significantly minimized or prevented, that any intentional hazards are addressed consistent with Section 420, and that the food would not be adulterated or contain an	FFDCA §§ 402(a)(4). Food is adulterated if it has been prepared, packed, or held under unsanitary conditions where it may have become contaminated by filth or rendered injurious to health. FFDCA § 416. Sanitary Transportation Practices

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	undeclared allergen. Preventive controls expressly include the following controls: • Sanitation • Training • Environmental controls • Allergen controls • Recall contingency plan • GMPs • Supplier verification activities Each facility would be required to monitor the controls; establish corrective actions; maintain records of monitoring, instances of nonconformance, and corrective actions taken to ensure that if the controls are not properly implemented or are found to be ineffective the likelihood of reoccurrence is reduced and all affected food is evaluated and prevented from entering commerce if it cannot be ensured that it is not adulterated; and verify that the plan is working, including through the use of environmental and product testing programs. The results of the hazard evaluation and identification of preventive controls would be required to be reduced to writing and made available to FDA during an inspection (along with documentation that the plan is being implemented, including monitoring, instances of nonconformance material to food safety, results of testing and other appropriate means of verification, corrective actions, and efficacy of preventive controls and corrective actions). Verification activities include the use of environmental and product testing and other appropriate means. A hazard reanalysis would be required at least every three years or when a significant change is made in the activities conducted at a facility. The reanalysis must be completed before the change in activities begins. FDA also could require a reanalysis to respond to new hazards or developments in scientific understanding or results of risk assessments from the Department of Homeland Security.	

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	Within 18 months, FDA would promulgate regulations establishing minimum standards for the effective implementation of this section and would have to review existing domestic and international standards (such as the Pasteurized Milk Ordinance) to ensure consistency with such standards, as appropriate. The regulations must provide sufficient flexibility to small businesses, comply with the Paperwork Reduction Act, and not require any facility to hire a third party to identify, implement, or audit preventive controls. FDA would not have the authority to apply specific controls or practices or specific technologies to an individual facility. FDA would be required to coordinate with the Secretary of Homeland Security when promulgating regulations for intentionally introduced hazards. Within 9 months, FDA would be required to issue a proposed rule clarifying the on-farm activities that would require facility registration. FDA would need to conduct a science-based risk analysis of such activities and exempt certain small facilities engaged in low-risk activities from the preventive controls requirements and inspection frequency. FDA would be required to issue a final rule within 9 months of the close of the comment period for the proposed rule. FDA would be required to issue a SECG within 180 days of enactment. The preventive controls requirements would take effect within 18 months of enactment for large firms. FDA is to define, by regulation, "small business" and "very small business" after conducting a study. The effective date for small businesses and very small businesses would be 6 months and 18 months, respectively, from the date of completion of this regulation. Scope: Section excludes: (a) warehouses, the storage of raw agricultural commodities other than fruits and vegetables intended for further processing or distribution, and pet food manufacturers at FDA's	

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	discretion; (b) those facilities subject to the companion section on the safety of fruits and vegetables; (c) facilities subject to other FDA HACCP or analogous regulatory programs (seafood, juice and low acid canned foods); (d) dietary supplements; and (e) alcohol related facilities. Limited Exemption: Provides an exemption from preventive controls for qualifying very small businesses with limited size and limited scope of distribution. However, the facility is still subject to the registration requirement. · The limited size is for annual sales (3 year average) of less than $500,000. · The limited scope of distribution is either intrastate or within a 275 mile radius (includes Canadian or Mexican imports). · A majority of the distribution must be directly to consumers or directly to restaurants or retail food establishments (i.e., not through distributers). · The product label (if it has one) must include the name/place of business, or if no label, this information must be provided in a written placard or some other suitable means. · To qualify, the facility must submit to FDA either: (a) documentation that it is applying preventive controls; or (b) documentation that it is in compliance with state, local or other non-Federal requirements. · The exemption can be withdrawn by FDA, on a qualifying facility basis, if the food is directly linked to a foodborne illness outbreak. Within 180 days, FDA would be required to update the Seafood HACCP guidance document.	

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	There would be no limitation on the agency to revise, issue, or enforce product or category specific regulations such as existing HACCP programs. Failure to comply with this section would be a prohibited act. (Sec. 103)	
Performance Standards	Every two years, FDA would be required in coordination with USDA and based on studies, GMPs, and recommendations of relevant advisory committees, to review and evaluate "the most significant foodborne contaminants" and, when appropriate, FDA would then issue "contaminant-specific and science-based guidance documents" including "action levels, or regulations" to help prevent adulteration. The standards would be applicable to products and product classes; shall, where appropriate, differentiate between food for humans and food for animals; and would not be facility specific. (Sec. 104)	FFDCA § 406. FDA can establish tolerances for poisonous ingredients in food. FFDCA § 408. Tolerances and Exemptions for Pesticide Chemical Residues
Produce Safety Standards	Within a year of the bill's enactment, FDA, in consultation with USDA, state departments of agriculture, and the Secretary of Homeland Security, would be required to publish a proposed rule establishing science-based standards for the safe production and harvesting of those types of fruits and vegetables (including mixes or categories of fruits and vegetables) for which FDA has determined that such standards would "minimize the risk of serious adverse health consequences or death." FDA is instructed to prioritize regulations for fruits and vegetables that have been associated with food-borne illness outbreaks. FDA would be required to give flexibility to different types of entities including farms that sell directly to consumers, as well as consider conservation practices and organic production requirements. FDA could modify the requirements for or exempt small and very small businesses that produce and harvest low-risk fruits and vegetables. The regulations also must provide flexibility to small business and comply	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	with the Paperwork Reduction Act. FDA must also acknowledge differences in risk and minimize the number of separate standards that apply to separate foods. FDA may not require a facility to hire a consultant or third party. Within 180 dates after the regulations are promulgated, FDA would be required to issue a SECG. FDA to define, by regulation, "small business" and "very small business." The effective date for small businesses and very small businesses would be 1 year and 2 years, respectively, from the date of completion of this regulation. During the proposed rulemaking comment period, FDA would be required to conduct at least 3 public meetings in diverse geographical areas. A final rule would be required within a year of the closing of the comment period on the proposal. The regulations must permit states and foreign governments to seek variances from the requirements and provide for coordination of education and enforcement activities with states and local governments. FDA may also coordinate with USDA. Also within a year of the bill's enactment, guidance would be published updating good agricultural practices. FDA would be required to hold at least 3 public meetings to conduct education and outreach regarding the guidance. Violation of the regulations would be a prohibited act. Scope: This section does not apply to facilities subject to the companion section on preventive process controls. Limited Exemption: Provides an exemption from mandatory produce standards for qualifying very small farms with limited size and limited scope of distribution.	

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	· The limited size is for annual sales (3 year average) of less than \$500,000. · The limited scope of distribution is either intrastate or within a 275 mile radius (includes Canadian or Mexican imports). · A majority of the distribution must be directly to qualified end-users – directly to consumers or directly to restaurants or retail food establishments (i.e., not through distributers). · The product label (if it has one) must include the name/place of business, or if no label, this information must be provided in a written placard or some other suitable means. · The exemption can be withdrawn by FDA, on a facility basis, if the food is directly linked to a foodborne illness outbreak. There would be no limitation on the agency to revise, issue, or enforce product or category specific regulations such as existing HACCP programs. Does not apply to persons who grow food for own personal consumption. (Sec. 105)	
Protection Against Intentional Adulteration	FDA would be required to promulgate regulations to protect food against intentional adulteration within 18 months after enactment. These regulations would apply only to food in bulk or batch form prior to being packaged for the final consumer for which FDA has identified clear vulnerabilities and for which there is a high risk that intentional adulteration could cause serious adverse health consequences or death. To make these determinations, FDA would be required to conduct vulnerability assessments of the food system, taking into consideration risk assessments by the Department of Homeland Security, consider risks and costs, and determine the types of science-based strategies necessary	FFDCA § 801(h). Requires FDA to give high priority to increasing the number of inspections for the purpose of enabling FDA to inspect food offered for import at ports of entry into the U.S., with the greatest priority given to inspections to detect the intentional adulteration of food.

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	for protection. Within a year of enactment, FDA would be required to issue guidance documents related to protection against intentional adulteration of food. FDA and the Department of Homeland Security could determine the time, manner and form in which the guidance documents are made public. Failure to comply with these regulations would be a prohibited act. Scope: This section would not apply to foods produced on farms, except for milk. (Sec. 106)	
Traceability	Within 9 months of enactment, FDA would be required to conduct pilot projects, in cooperation with the applicable food sector, to explore methods to improve the tracking and tracing of food. The bill would require separate pilot projects for: (a) packaged food; and (b) fruits and vegetables that are raw agricultural commodities. After completion of the pilot projects, FDA would be required to establish within the agency a product tracing system to receive information to track and trace food. FDA would be required to ensure that the parameters of such system are supported by the results of the pilot projects. FDA would be required to conduct additional data gathering to assess the cost and benefits associated with adoption of product tracing technologies, the feasibility of such technologies for different food sectors, and whether such technologies are compatible with the statutory requirements for this section. FDA would also be required to evaluate domestic and international product tracing practices in commercial use, consider international efforts, and consult with a diverse and broad range of experts and stakeholders. Within 2 years of enactment, FDA would be required to issue a proposed rule to establish additional recordkeeping requirements for product tracing but such requirements would apply only to high-risk foods. FDA would have to consider certain factors when determining whether a food is high-risk for purposes of product tracing, including the history of	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	outbreaks attributed to the food and the likelihood of contamination and steps taken during manufacturing to reduce the likelihood of contamination. The new recordkeeping requirements could not prescribe the use of specific technologies, could not require the creation of duplicate records, could not require a facility to change business systems, could not require the full pedigree of the food, and could not require product tracing the case level. The new requirements would not apply to certain farm sales of food, fishing vessels, or commingled raw agricultural commodities, and FDA would not be permitted to impose any limitations on the commingling of food. A “commingled raw agricultural commodity” would be defined as any commodity that is combined or mixed after harvesting but before processing, but would not include certain types of fruits and vegetables as determined by FDA. The term “processing” would mean operations that alter the general state of the commodity, such as canning, cooking, freezing, dehydration, milling, grinding, pasteurization, or homogenization. Grocery stores would be required to maintain records documenting the farm that was the source of the food. FDA would be able to provide additional exemptions or modifications for specific types of food or facilities if the agency determines that such requirements are not necessary to protect the public health. During an active investigation of a foodborne illness outbreak, FDA would be able to request that a farm identify potential immediate recipients of the food that is the subject of the investigation. Within 2 years of enactment, FDA would be required to publish a proposed regulation covering the recordkeeping requirements associated with product tracing of “high risk” foods, to be followed by public meetings to obtain input from different regions of the country. Such proposed requirements would, among other things: (1) be required to be	

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	science based; (2) ensure that the public health benefits outweigh the costs of compliance; (3) be scale appropriate; (4) minimize the number of different requirements for facilities that handle more than one type of food; and (5) ensure that FDA has procedures in place to protect trade secret or other confidential information. Within 1 year of enactment, the GAO would be required to submit a report to Congress evaluating the benefits and risks of limiting product tracing requirements to high-risk foods and of limiting the participation of restaurants. Small businesses would have an additional year to comply with any final regulations and very small businesses would have an additional 2 years to comply. FDA also would be required to issue a SECG. The new traceability requirement would also apply to imported products. Failure to comply with any recordkeeping requirements would be a prohibited act. (Sec. 204)	
Inspection Frequency	FDA would be required to adopt a risk-based approach to inspections of facilities, taking into account the known safety risks of the food, the history of recalls at the facility, the rigor of the facility's preventive controls plan, whether the food may be subject to intentional adulteration and thus receive high priority for inspection at importation, and whether the facility is certified. (Same for imports, including the rigor of the foreign supplier verification of the importer and whether the importer participates in the Voluntary Qualified Importer Program). High risk facilities would be subject to inspection once in the first five years after enactment and then at least once every three years. Low risk facilities would be subject to inspection at least once in the first seven years after enactment and then at least once every five years. To meet this requirement, FDA could rely on inspections conducted by other	FFDCA §704. FDA has the authority to conduct inspections, but the frequency of inspection is not established.

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	Federal, state or local agencies. For foreign facilities, in the first year after enactment, FDA would be required to inspect 600 foreign facilities; for each year thereafter, the agency would be required to double the number of inspections of foreign facilities every year for five years. FDA would be permitted to enter into interagency agreements to facilitate the inspection of seafood. FDA would be required to submit an annual report to Congress regarding inspection frequency and whether the agency is meeting the mandated frequency requirements. FDA would be authorized to consult with any HHS advisory committee in determining the allocation of inspection resources. (Sec. 201)	
Record Keeping and Records Access	If FDA has a reasonable belief that an article of food presents a threat of serious adverse health consequences or death, FDA would have access to and be able to copy all records relating to such article of food and would have access to records for any "other article of food" that "the Secretary reasonably believes is likely to be affected in a similar manner." These related articles would likely include food produced on the same manufacturing line. (Sec. 101) FDA would be required to issue a notice of proposed rulemaking to establish standards for the type of information, format and timeframe for the submission of records to FDA to assist in FDA traceback activities in the event of a food-borne illness outbreak involving fruits and vegetables. (Sec. 204) FDA would have access to preventive control plans and associated documentation of implementation in order to verify compliance. (Sec. 103)	FFDCA § 414. If FDA has a reasonable belief that a food is adulterated and presents a threat of serious adverse health consequences or death, FDA can have access to all records relating to such article needed to determine if it is adulterated or presents a threat of serious adverse health consequences or death. Additionally, under this same standard FDA can request records relating to the reportable food registry. FDA is authorized to enact regulations requiring records of immediate previous sources and subsequent recipients of articles of food (and their packaging). FFDCA § 703. (FDA can inspect records relating

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	FDA would have access to records relating to the Foreign Supplier Verification Program and FDA would have access to inspection reports and other documentation gathered by third party auditors during the auditing process. (Sec. 301)	to the interstate transport of foods.) FFDCA § 704. (FDA can inspect records regarding infant formula.)
Imports—Foreign Supplier Safety Assurance Program	Each importer of food (defined as the owner of the food at the time of entry into the United States) would be required to have in place a program to verify that its imported food is produced in accordance with U.S. requirements (including the new preventive controls and produce standards), is not adulterated and does not contain an undeclared allergen. FDA would be required to issue guidance on the development of foreign supplier verification programs and promulgate regulations regarding the content of these programs. Regulations would establish the process for verification by a United States importer for each relevant foreign supplier. Related records would be required to be maintained for two years and made available upon request. FDA would be required to publish a list on the Internet of the name and location of importers participating in this program. An exemption would be provided for importers of seafood, juice, and low-acid canned foods required to comply with HACCP based regulations. FDA would be required to publish a notice in the Federal Register exempting research samples and food for personal consumption. The importation of food without a foreign supplier safety assurance program would be a prohibited act. (Sec. 301)	NONE
Imports—Expedited Entry	FDA would be required to establish, in consultation with DHS, a program for expedited review and importation of products from importers voluntarily participating in a qualified importer program. Importers that wish to participate would be required to provide notice and an application to FDA. Eligibility for the program would require third party certification and consideration of the nature of the food, risk of intentional adulteration of the food, compliance history of the foreign supplier, exporting country's capability for ensuring compliance with	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	U.S. standards, compliance with the foreign supplier verification program, and recordkeeping, testing, facility inspections and audits, traceability, temperature controls, and sourcing practices of the importer. FDA would be permitted to allow the expedited review and importation by importers of certain foods or from certain countries based on these criteria. FDA would be required to reevaluate importers qualified under this program every three years. To qualify under the program, importer must be importing food from certified facilities. (Sec. 302) The bill would establish a user fee for this program. (Sec. 107)	
Imports— Third Party Certification	Certification may be required, based on considerations, including risks associated with the type of food or its place of origin, or a finding by FDA that the food safety system of the country of origin is inadequate. If FDA does determine that the food safety system of a foreign region, country or territory is inadequate, FDA would be required to identify the inadequacies and establish a process for the foreign government to inform the agency of improvements to its program. These certifications or assurances could be provided in the form of shipment-specific certificates, a listing of certified entities, or in other form specified by FDA. FDA could require that certifications be renewed as deemed appropriate and refuse to accept certifications it deems no longer valid. The requirement for such certification would not prevent the FDA from conducting random checks of the covered imports. (Sec. 303) FDA would implement a system whereby (a) it would recognize accrediting bodies that operate in accordance with established standards, rather than carrying out that function itself (however, if FDA hasn't recognized an accreditation body in two years, FDA would be able to directly accredit third-party auditors); (b) the accreditation bodies would then evaluate and accredit third party auditors; and (c) the third party auditors would certify that foreign facilities meet the requirements of the Act. FDA would issue model standards that accrediting bodies should ensure auditors meet. The program would apply to imported foods only.	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	As a condition of accreditation, an auditor would be required to agree to issue a written and electronic certification to accompany each food shipment made for import from a facility certified. Such certificates would be considered by FDA when targeting inspection resources. Certification would be required to participate in the Voluntary Qualified Importer Program. FDA would be authorized to monitor auditors, conduct its own inspections, and review inspection reports generated by auditors. The bill draws a distinction between consultative audits and regulatory audits, with this provision directed to regulatory audits. However, reports from the consultative audits would be accessible under Section 414 of the Act. The agency would also publish a public list of accreditation bodies and accredited third party auditors. FDA would be required to issue regulations regarding conflicts of interest, including a requirement that audits be unannounced. In addition, false statements to auditors would be considered a criminal act. Auditors would be required to immediately notify FDA upon discovering "a condition that could cause or contribute to a serious risk to the public health." FDA could withdraw accreditation from an auditor if food from a facility it certifies is linked to an illness outbreak, if the auditor no longer meets requirements, or following a refusal to allow U.S. officials to conduct necessary audits. To make the program revenue-neutral, FDA would establish a method by which auditors reimburse FDA for the work performed to establish and administer the accreditation system; no revenue surplus should be generated. (Sec. 307)	

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
Imports—Laboratory Testing	FDA would be required to provide for the recognition of accreditation bodies that accredit laboratories – including independent private laboratories and laboratories operated by a Federal agency – and to establish a publicly available registry of recognized accreditation bodies and accredited labs. As a condition of inclusion on this registry, accreditation bodies would have to require that laboratories meet certain model standards developed by FDA. Foreign laboratories that meet these standards are also eligible for accreditation. FDA would be required to periodically reevaluate all recognized accreditation bodies every five years and to revoke recognition if warranted. FDA would be directed to work to increase the number of accredited labs. Within 30 months of enactment, either federal labs or labs accredited by an accreditation body on FDA's registry would be required to be used for all food testing in support of admission of an imported food, as required by specific regulations (but only when applied to address an identified or suspected food safety problem), as required by an Import Alert, or as otherwise deemed appropriate by FDA (also to meet an identified or suspected food safety problem) and the test results would be provided directly to FDA. FDA could, by regulation, exempt certain test results from the requirement that they be submitted directly to the agency. If the testing of food by a state-run lab results in a state recall of a particular food, FDA would be required to review the sampling and testing results to determine the need for a national recall. Also, FDA could waive the required use of an accredited lab if new methodologies have been developed and validated and are necessary to protect the public health during a foodborne illness outbreak but a laboratory has not yet been accredited to use them. (Sec. 202)	NONE
Imports—Prior Notice	Prior notice of an imported food would be required to include the name of any country that refused entry to the food. (Sec. 304)	FFDCA § 801(m). Requires FDA, in consultation with the Secretary of the Treasury, to require prior notice to FDA for all imported food.

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
Imports—Foreign Inspectorate	FDA would be authorized to enter into agreements with foreign countries to facilitate the inspection of registered foreign facilities and require that inspection resources be directed to those facilities that present the highest risk. (Sec. 306) By October 1, 2011, the bill would require the Secretary to submit a report to Congress describing the process and progress in establishing offices in foreign countries. (Sec. 308)	NONE
Imports—Building Capacity of Foreign Governments	The bill would require FDA, within two years of enactment, to develop a plan to expand the technical, scientific, and regulatory capacity of foreign countries exporting food to the United States. Reflecting consultation with other government agencies, the plan would include recommendations for bilateral or multilateral agreements, provisions for electronic data sharing, provisions for mutual recognition of inspection reports, training of foreign governments and producers, recommendations for harmonization with the Codex Alimentarius, and provisions for multilateral acceptance of laboratory methods and detection techniques. (Sec. 305)	NONE
Imports—-Smuggled Food	In consultation with DHS, FDA would be required to develop and implement a strategy to better identify and prevent the entry of smuggled food. FDA would be required to publicly warn consumers of smuggled food that the agency reasonably believes would cause serious adverse health consequences or death. (Sec. 309)	NONE
Imports—Port Shopping	FDA would be required to coordinate with the Department of Homeland Security on any food refused admission into the U.S. in order to prevent port shopping by the importer. (Sec. 115)	NONE
Compliance with International Agreements	The bill provides that it should not be construed in a manner inconsistent with the World Trade Organization treaty. (Sec. 404)	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
Suspension of Registration	FDA would have the authority to suspend the registration of any facility if FDA determines that food manufactured, processed, packed or held by that facility "has a reasonable probability of causing serious adverse health consequences or death" and the facility was responsible for the adulteration or, in the case of facilities that merely pack, receive or hold food, the facility knew or had reason to know that the food presented a reasonable probability of causing serious adverse health consequences or death. Informal hearings to challenge a suspension determination would be permitted. Issuance of an order to suspend registration and authority to hold an informal hearing would be assigned to the FDA Commissioner and could not be further delegated. Following such hearings, the Commissioner could either vacate the order or require the submission of a corrective action plan before lifting the suspension. Any facility with a suspended registration would be prohibited from importing or otherwise introducing food into interstate commerce. FDA would promulgate regulations describing the standards used in deciding to suspend a registration. Suspension of registration would take effect the date that FDA issues such regulations, or 180 days after enactment, whichever is earlier. (Sec. 102)	NONE
Notification and Reporting	FDA would be authorized to require a responsible party to submit consumer-oriented information regarding a reportable food to the Reportable Food Registry, including a description of the food, the affected product identification codes, and contact information for the responsible party. FDA would be required to prepare this information as a standardized one-page summary to be published on the FDA website. If a grocery store that is part of a chain of at least 15 stores sold such food, then the store would need to prominently display the summary within 24 hours for 14 days. FDA would be required to develop a list of acceptable locations from which grocery stores would choose one to provide the notification. These would include posting near the register, the location of the reportable food, and providing targeted recall information to consumers at purchase. The knowing and willful failure	FFDCA § 417. Reportable Food Registry (applies to the person submitting the registration for a registered food facility and when there is a reasonable probability that an article of food will cause serious adverse health consequences or death).

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	to comply with this requirement would be a prohibited act. (Sec. 211)	
Mandatory Recall Authority	FDA would be granted mandatory recall authority if a company refuses to voluntarily recall a product for which “there is a reasonable probability” that the food is adulterated or contains an undeclared food allergen and consumption of the food will cause “serious adverse health consequences or death.” Procedures would be established for informal hearings on mandatory recall orders and the authority to issue a mandatory recall order would not be delegated beyond the FDA Commissioner. FDA would also be required to consult USDA policies in determining whether to publish a public list of retail consignees involved in a Class I recall. FDA would be required to publish on the web a picture of a recalled food. The agency would be required to establish a web-search engine to allow consumer access to information regarding a food that is subject to a recall. The bill would require FDA to establish an incident command operation that would operate within 24 hours of the initiation of a class I recall, regardless of whether the recall was mandated or conducted voluntarily. Additionally, FDA would be required to provide an annual report to Congress identifying when the agency used the mandatory recall authority and the circumstances by which the agency concluded that the situation warranted use of such authority. Failure to comply with a recall order would trigger a civil money penalty. It would also constitute a prohibited act for which criminal penalties are provided under existing law. FDA would not be able to require the recall of alcoholic beverages without first providing the Alcohol and Tobacco Tax and Trade Bureau	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	the opportunity to recall the article. GAO would be directed to provide a report to Congress within 90 days of enactment reviewing state and federal mandatory recall authority and the mechanisms available to compensate parties for wrongfully ordered recalls. Within 90 days of the report, USDA would be directed to conduct a study on the ability to implement a farmer restitution program. (Sec. 206)	
Administrative Detention	FDA would be provided with administrative detention authority when the agency "has reason to believe" that a food "is adulterated or misbranded." FDA would be required to issue an interim final rule implementing this provision. (Sec. 207)	FFDCA § 334(h). FDA may order the administrative detention of an article of food if an officer or qualified employee has "credible evidence or information indicating that such article presents a threat of serious adverse health consequences or death."
Civil Penalties	Failure to comply with a mandatory recall order would trigger a civil money penalty of no more than $50,000 per individual and $250,000 per other entities, not to exceed $500,000 for all related violations. Because the bill would amend the existing civil penalties provision in the Act applicable to other FDA-regulated products, civil penalties could only be assessed after an opportunity for a hearing. (Sec. 206)	FFDCA § 303(f)(2). Persons who introduce adulterated food due the presence of <u>pesticides</u> into interstate commerce are liable to civil penalties of $50,000 for an individual, $250,000 for any other person, not to exceed $500,000 in a single proceeding. Farmers are not subject to this penalty. If FDA assesses a civil penalty, it may not use its criminal authorities or seizure/injunction authorities.
Criminal Penalties and False Statements	False statements by or to third party auditors would be subject to criminal liability under 18 U.S.C. § 1001 of the Federal Criminal Code. (Sec. 307) Any false statement or representation by an importer to the FDA would be subject to criminal liability under the Federal Criminal Code. (Sec. 302)	FFDCA § 303. Violations of the prohibited acts section result in one year imprisonment, a fine of $1,000, or both. Repeated violations or violations with the intent to defraud or mislead result in up to 3 years imprisonment or a fine of $10,000, or both.

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
Whistleblower Protections	Whistleblowers would receive protection against retaliation or discrimination. (Sec. 402)	NONE
Inspection Authority	The importation of food from foreign facilities that refuse to permit, limit, or unduly delay United States inspections would be prohibited. The Department of Commerce would be authorized to send inspectors to foreign facilities and countries for seafood inspections. (Sec. 306)	FFDCA § 704. This section sets forth FDA's inspection authority.
Fees—Recalls	The bill would authorize fees to cover recall related activities performed by FDA, capped at $20 million annually. Fees would be assessed only against those companies/importers that do not comply with a mandatory recall order. (Sec. 107)	NONE
Fees—Reinspection	FDA would have authority to collect fees to fully defray the costs of reinspections. Fees would be assessed against those companies/importers subject to the reinspection. Reinspection related fees would be capped at $25 million. (Sec. 107)	NONE
Fees—Voluntary Importer Program	The bill would authorize user fees for participation in the Qualified Importer Program equivalent to the cost of the activity. (Sec. 107)	NONE
Fees—Export Certificates	The bill would authorize FDA to certify food and animal feed for export and charge a fee not to exceed $175 for each certification. (Sec. 107)	NONE
Authorization of Appropriations	The bill would authorize appropriations for FDA's Center for Food Safety and Applied Nutrition, Center for Veterinary Medicine, and related activities in the Office of Regulatory Affairs as may be necessary for 2011 through 2015. The bill also sets a goal that the field inspection	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	staff for FDA's food safety programs should increase by over 1,000 persons over a 5 year period, which must include 150 employees for food defense and smuggled food. (Sec. 401)	
Food Defense Strategy	HHS and USDA, in consultation with DHS, would be required to submit to Congress a National Agriculture and Food Defense Strategy, which would include a coordinated research agenda and a description of the process for meeting the following goals: (1) enhancing the preparedness of the agriculture and food system, (2) improving agriculture and food system detection capabilities, (3) ensuring an efficient response to agriculture and food emergencies, and (4) securing agriculture and food production after an emergency. Every four years, a revised plan would be submitted to Congress. The three agencies also would be required to develop metrics to measure progress and report on the progress measured. (Sec. 108)	NONE
Food and Agriculture Coordinating Councils	USDA, FDA, and DHS would be required to submit a report to Congress on the activities of the Food and Agriculture Sector Coordinating Council and the Government Coordinating Council. (Sec. 109)	NONE
Domestic Capacity	FDA, in coordination with USDA and DHS, would be required to submit a report to Congress identifying its food safety programs and practices. This would include descriptions of the following: analysis of the need for additional regulations or guidance, outreach to food industry sectors, systems for distributing information and technical assistance to industry, communication systems to disseminate information concerning specific threats, surveillance systems to detect foodborne illness outbreaks, and resources needed to implement the plan. This report also should include information on risk-based activities, the capacity for laboratory analyses, information technology, and recommendations for enhanced surveillance, outbreak response and traceability involving fruits and vegetables. Thereafter, FDA would be required to submit a report on a biennial basis	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	reviewing previous food safety programs and practices and identifying future ones. In addition, on a biennial basis, FDA would be required to submit a food safety and food defense research plan to Congress. Also, FDA would be required to evaluate the effectiveness of its programs and report to Congress on this evaluation within 1 year of enactment. (Sec. 110)	
Sanitary Transportation of Food	Within 18 months of enactment, the bill would require FDA to promulgate regulations regarding the sanitary transportation of food. FDA also would be directed to study the transportation of food, including an examination of the unique needs of rural areas. (Sec. 111)	FFDCA § 416. Requires FDA to establish regulations that require shippers, carriers by motor vehicle or rail vehicle, receivers, and other persons engaged in the transportation of food to use sanitary transportation practices prescribed by the Secretary to ensure that food is not transported under conditions that may render the food adulterated.
Food Allergy and Anaphylaxis Management	Secretary of Health and Human Services, in consultation with the Secretary of Education, would be directed to develop voluntary, food allergy management guidance to manage the risk of food allergy and anaphylaxis in schools or early childhood education programs. In addition, the bill would provide for non-renewable food allergy management incentive grants for up to two years to assist local education agencies with adoption and implementation of the voluntary food allergy management guidelines. (Sec. 112)	NONE
Integrated Consortium of Laboratory Networks	Department of Homeland Security (DHS), in consultation with HHS, USDA, and EPA, would be required to maintain an agreement through which laboratory network members could do the following: (1) agree on common lab methods for the sharing of information, (2) identify the means by which the members could work cooperatively, and (3) engage in ongoing dialog and build relationships to support integrated responses during emergencies. (Sec. 203) FDA, in coordination with USDA and DHS, would have to submit periodic reports to Congress on the implementation of the food	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	emergency response network of laboratories. (Sec. 202)	
Surveillance	The CDC would be required to enhance food-borne illness surveillance systems to improve the collection, analysis, reporting and usefulness of data on food-borne illness by, among other activities, coordinating with federal, state, and local surveillance systems; increasing participation in national networks of public health; facilitating the sharing of findings among governmental agencies on a timely basis; and, developing improved epidemiological tools. This section would also require FDA to develop and implement strategies to leverage and enhance the food safety and defense capacities of state and local agencies. In addition, the bill would establish a working group of experts and stakeholders to make recommendations on improving food-borne illness surveillance. The bill would authorize appropriations of $24 million to carry out this provisions. (Sec. 205)	NONE
Decontamination and Disposal Standards and Plans	EPA would be required to provide support for and technical assistance to state and local governments in preparing for, assessing, decontaminating, and recovering from an agriculture or food emergency. To do this, the EPA would develop and disseminate specific standards, including model plans, concerning clean up, clearance, and recovery activities following the decontamination and disposal of specific threat agents and foreign animal diseases. Exercises to identify weaknesses in the plans would be conducted at least annually, with modifications to the plans made at least every two years. (Sec. 208)	NONE
Jurisdiction	Jurisdiction between FDA and USDA and the Alcohol and Tobacco Tax and Trade Bureau would not be changed. (Sec. 403) In general, many of the bill's provisions would not apply to alcohol facilities required to register with FDA under Section 415 because they are engaged in the manufacturing, processing, packing or holding of alcoholic beverages. This exemption would not apply to facilities	NONE

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	engaged in activities involving non-alcohol food, unless the food is received and distributed in prepackaged form and constitutes not more that 5% of overall sales of the facility. (Sec. 116)	
New Dietary Ingredients	If FDA determines that a new dietary ingredient notification is inadequate to support the safety of the substance because it is or contains an anabolic steroid or an analogue of an anabolic steroid, it would be required to notify the Drug Enforcement Administration. Within 180 days of enactment, FDA would be required to issue guidance clarifying what constitutes a new dietary ingredient, when a new dietary ingredient notification is necessary, and the evidence needed to document the safety of the ingredient. (Sec. 113)	NONE
Post Harvest Processing of Raw Oysters	The bill would direct FDA to submit a report to Congress 90 days prior to issuing a new guidance, regulation or other related action with respect to the post-harvest processing of raw oysters. Such a report would not be required if FDA issues a guidance that is adopted as a consensus agreement between federal and state regulators and the oyster industry, acting through the Interstate Shellfish Sanitation Conference. (Sec. 114)	NONE
Training	The bill would require the agency to set standards and administer training and education programs for state and local food safety officials. FDA would be authorized to use such employees to conduct inspections and investigations. Within 180 days of enactment, FDA would be required to enter into memoranda of understanding with USDA to establish a competitive grant program to provide training and education to farms, small processors and small fruit and vegetable wholesalers. (Sec. 209)	FFDCA § 742. HHS is required to conduct training and education programs for FDA employees.

	FDA Food Safety Modernization Act (S. 510) (Durbin)	Current Law (FFDCA)
	FDA also would be authorized to make grants to states and localities, as well as nonprofit food safety training entities that partner with an institution of higher education, to undertake inspections and investigations and to undergo training. (Sec. 210) CDC would establish 5 Integrated Food Safety Centers of Excellence to serve as resources for federal, state, and local public health professionals to respond to foodborne illness outbreaks. The centers would be headquartered at selected state health departments. Within two years of enactment, the Secretary would submit a report to Congress regarding the effectiveness of the centers. (Sec. 210)	
Budgetary Effects	Budgetary impact shall be determined under statutory Pay-As-You-Go Act of 2010. (Sec. 405)	None

Duties of In-House Counsel in Initiating and Conducting Internal Investigations

By Robert R. Stauffer and Reena Sikdar

I. Circumstances warranting an internal investigation

When there is credible evidence of serious misconduct in the corporate setting, an investigation is imperative; the advantages of conducting an investigation far outweigh the disadvantages. Indeed, the failure to investigate can be perceived as so serious that it may overshadow the underlying offense. A corporation cannot afford the risks imposed by a failure to investigate and disclose internal wrongdoing. The question is no longer whether to conduct an investigation, but rather how to conduct the investigation to prevent indictment, improve public relations, and minimize such consequences as civil lawsuits by third parties.

Various circumstances may warrant an internal investigation:

- Receipt of information suggesting illegal conduct will often necessitate an internal investigation. Such information may come from any number of sources, including employees, third parties (such as customers or suppliers), the government, auditors, or counsel.

- If a corporation learns that a government agency has initiated a civil or criminal investigation, an internal investigation may be warranted. Although some of the benefits of an internal investigation may be lost by this time, the failure to investigate even in the face of a formal government inquiry may reflect poorly on the corporation and hamper its defense and may hurt the corporation at the sentencing stage.

- Upon the initiation of a shareholders derivative lawsuit, a corporation may appoint an independent litigation committee, composed of outside directors, which will hire counsel to perform an investigation. The findings of the committee may be significant in convincing the court to dismiss the lawsuit. *Johnson v. Glassman*, , 401 N.J. Super. 222 (App. Div. 2008). *But see Sutherland v. Sutherland*, 958 A.2d 235 (Del. Ch. 2008) (denying motion to dismiss where one-person special litigation committee's investigation was inadequate; report by the committee neglected to mention certain payments even though the payments represented the type of suspected activity that motivated the lawsuit, and the committee destroyed its original interview notes, undermining the court's confidence in the good faith and reasonableness of the investigation).

- A corporation may agree to perform an internal investigation as the result of a consent decree with a government agency. *E.g.*, *Gaines v. Haughton*, 645 F.2d 761, 767 (9th Cir. 1981), *cert. denied*, 454 U.S. 1145 (1982).

II. Legal duty to investigate

A. Express statutory or regulatory duty

In some circumstances, particularly in highly regulated industries, a statute or regulation may expressly impose on the company a duty to investigate misconduct. For example, the Food and Drug Association requires that a company "immediately initiate an investigation" when it suspects that records have been destroyed, samples are being diverted, or there is a significant loss or known theft of product. 21 C.F.R. 203.37(a)-(b)

In the securities industry, Sections 15(b)(4)(E) and 15(b)(6) of the Securities Exchange Act, 15 U.S.C. §§ 78o(b)(4)(E), 78o(b)(6), require broker-dealers and individuals associated with broker-dealers to supervise persons subject to their supervision with a view to preventing violations of the securities laws. *See also Monieson v. CFTC*, 996 F.2d 852, 860-61 (7th Cir. 1993) (chairman of board of futures commission merchant liable as control person where he failed to inquire adequately upon receiving reports of improper trading by employees). "Controlling persons cannot deliberately or recklessly avoid obtaining knowledge about potential wrongdoing." *Id.*

The SEC has elaborated on these provisions in a series of opinions emphasizing the importance of investigating and addressing misconduct. In *In re Gutfreund*, SEC Admin. Proceeding File No. 3-7930 (Dec. 3, 1992), concerning illegal Treasury bond bids by Salomon Brothers, the SEC stated that corporate officers who learned of illegal conduct by an employee were obligated to investigate what had occurred; to determine whether there had been other instances of unreported misconduct; to increase supervision of the employee and limit his activities; to clearly define the responsibilities of those who were to respond to the wrongdoing; and to take actions reasonably designed to prevent repetition of the misconduct. The SEC also stated that in-house counsel, even though he had unsuccessfully urged senior officers to report the violation, should have taken such further steps as directing an internal investigation, disclosing the matter to the board of directors, resigning, or informing regulators.

In *Report of Investigation in the Matter of Cooper Companies, Inc. as it Relates to the Conduct of Cooper's Board of Directors*, Exchange Act Release No. 34-35082, 58 SEC Docket 681 (Dec. 12, 1994), the board of Cooper Companies, Inc. had entrusted co-chairman Gary Singer with responsibility for investing liquid assets. Singer and his brother, Steven Singer, engaged in fraudulent securities trading schemes. In January, 1992, the SEC issued a Formal Order of Investigation, and the board's only response was to disclose the investigation in a Form 10-K which stated that Cooper was cooperating fully. In February, the Singers refused to answer questions by the Commission. Four days later, the board elected Steven Singer as Chief Operating Officer. In March, Cooper's lawyers learned that the U.S. Attorney's Office was investigating the company, and the board initiated an internal investigation by independent counsel. The investigators were unable to interview the Singers, but determined that Gary Singer had diverted $560,000 to personal and family accounts. The board took no action to reclaim these funds. In May, the SEC and the U.S. Attorney filed civil and criminal charges against two individuals, one of whom publicly implicated Gary Singer. The board took no action in response, and Steve Singer caused the company to publicly deny any wrongdoing and profess unawareness of any wrongdoing by officers or employees. Later that month, Gary Singer took a leave of absence, and the company continued his pay and benefits. The Singers continued to participate in the company's business, and Steven Singer was re-elected COO in July. Coopers and Gary Singer were subsequently convicted of fraud. The SEC issued a report "to emphasize that corporate directors have a significant responsibility and play a critical role in safeguarding the integrity of the company's public statements and the interests of investors when evidence of fraudulent conduct by corporate management comes to their attention." The company did not fulfill these obligations; it "failed to take immediate and effective action to protect the interests of the company's investors." In contrast, in *In the Matter of Boston Company*, Exch. Act Rel. No. 34-31822 (Feb. 4, 1993), the SEC cited the firing of a company's CEO, the institution of internal controls, and cooperation with the SEC in imposing only lenient sanctions.

This duty may extend beyond broker-dealers to publicly-traded companies generally. In *In the Matter of Rita L. Schwartz*, SEC Admin. Proceeding File No. 3-10187 (April 13, 2000), the SEC stated that "outside directors must maintain a general familiarity with the corporation's public disclosures and accounting practices and investigate 'red flags' that come to their attention indicating that the corporation's public disclosures may be false or misleading."

B. Common law duty of management and directors

Common law duties to investigate may also arise. Fiduciary duties to the corporation may include the duty to initiate an investigation when there are indications of misconduct, and failure to investigate could thus subject management to civil liability. *See generally* Knepper & Bailey, Liability of Corporate Officers and Directors (1988). *See also Hoye v. Meek*, 795 F.2d 893, 896 (10th Cir. 1986) ("Where suspicions are aroused, or should be aroused, it is the directors' duty to make necessary inquiries."). This may be particularly true in light of the incentives created by the U.S. Sentencing Guidelines, and by various pronouncements by the Department of Justice, the SEC and other agencies, to maintain effective compliance programs, including compliance monitoring and the investigation of alleged misconduct, in order to obtain a sentence reduction or reduce the likelihood of criminal charges to begin with. *See U.S. Sentencing Guidelines* Chapter 8; "Principles of Federal Prosecution of Business Organizations" (2008), avail. at www.usdoj.gov/opa/documents/corp-charging-guidelines.pdf ("Filip Memo"); *Statement of the Securities and Exchange Commission Concerning Financial Penalties*, SEC Press Release No. 2006-4 (Jan. 4, 2006).

Additionally, a failure to investigate in the face of evidence of wrongdoing could give rise to an inference of intent by the corporation. *See Chill v. General Electric Co.*, 101 F.3d 263 (2d Cir. 1996) (in securities fraud case, an egregious refusal to see the obvious or investigate the doubtful may give rise to an inference of recklessness that would satisfy the scienter requirement). Pursuant to general principles of criminal law, deliberate ignorance of the truth may constitute culpable knowledge. *See U.S. v. Hayes Int'l Corp.*, 786 F.2d 1499, 1504 (11th Cir. 1986) (knowledge element satisfied where corporation willfully failed to determine permit status of a hazardous waste facility); *Rizzuto v. U.S.*, 889 F. Supp. 698, 705-06 (S.D.N.Y. 1995) (in action by IRS for employee withholding unpaid to the government, responsible corporate officer is liable, in the absence of a reasonable belief that taxes were paid, for a "failure to investigate or correct mismanagement after having notice that withholding taxes have not been remitted to the Government"). *See also U.S. v. Valencia*, 907 F.2d 671, 679 (7th Cir. 1990); *U.S. v. Nicholson*, 677 F.2d 706, 710-11 (9th Cir. 1982). *Cf. Kinney v. Metro Global Media, Inc.*, 170 F. Supp. 2d 173 (D.R.I. 2001) (failure of accounting firm to "investigate the doubtful" led to inference of scienter; firm's motion to dismiss securities fraud claims denied).

C. Sarbanes-Oxley and Dodd-Frank

The Sarbanes-Oxley Act and Dodd-Frank Act do not create an express obligation to investigate misconduct, but their provisions arguably make such investigations imperative and thus reinforce any common law duties that may exist. For example, Section 404 of Sarbanes-Oxley requires that annual reports include a discussion of existence and effectiveness of internal control structures. Arguably those structures are not effective if misconduct allegations are not investigated. Similarly, Section 302 of Sarbanes-Oxley requires that the principal executive officer and principal financial officer certify that the financial statements "fairly present in all material respects the financial condition and results of operations of the issuer," that they are responsible for "establishing and maintaining internal controls," that they have designed such controls to ensure that material information is made known to them by others, that they have evaluated the effectiveness of the internal controls within 90 days prior to the report, and that they "have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date." 15 U.S.C. § 7241. It is difficult to imagine how such a certification can be made without an compliance program that includes initiation of internal investigations when indications or allegations of misconduct arise. And the whistleblower incentives of the Dodd-Frank Act increase the pressure on corporations to investigate misconduct so they can be in a position to make a disclosure to the SEC prior to any whistleblower report to the SEC which could deprive the corporation of the benefits of early disclosure and cooperation.

D. Duty of counsel to investigate

In-house and outside counsel may have specific obligations to investigate and report misconduct in some circumstances. Normally, an attorney's obligations to the client are limited to the express scope of the representation. Attorneys are not subject to a general duty to ensure that all of their client's behavior is legal; counsel's duty to provide legal services should not extend beyond the scope of the matters for which counsel was retained. *See Loyd v. Paine Webber, Inc.*, 208 F.3d 755, 760 (9th Cir. 2000) ("Nowhere did the court indicate that, as a general matter, an attorney who represents corporate clients has an automatic duty to independently investigate whether its clients are engaging in fraudulent conduct"); *Resolution Trust Corp. v. Blasdell*, 154 F.R.D. 675, 688-89 (D. Ariz. 1993) (attorney retained to "document" a transaction did not have "a general duty to be continually vigilant for possible regulatory violations," because that duty was outside the scope of the representation); *In re Consupak, Inc.*, 87 B.R. 529, 551 (Bankr. N.D. Ill. 1988 ("In general, a lawyer is not expected to give advice until asked by the client. . . . A lawyer ordinarily has no duty to initiate investigation of a client's affairs or to give advice that the client has indicated is unwanted"); *In re Grand Jury Subpoena (Legal Services Center)*, 615 F. Supp. 958 (D. Mass. 1985) (no duty to investigate client's position absent clear indications of client fraud); *Delta Equipment & Constr. Co. v. Royal Indemnity Co.*, 186 So.2d 454, 458 (La. Ct. App. 1966) ("The legal relationship of attorney and client is purely contractual and results only from the mutual agreement and understanding of the parties concerned"; "[a]uthorization to represent a client in connection with a specific legal matter does not imply authorization to handle all others, nor does the agreement or consent of an attorney to represent a prospective client in a particular matter create an attorney-client relationship as regards other business or affairs of the client").

However, in some circumstances, a court may find that the attorney's duties go beyond the scope of the retention to include rendering advice on other matters that come to light or to investigate potential legal problems. Where counsel receives information which suggests the existence of a legal problem for the client, there may be a duty to bring the matter to the client's attention, even if the matter is beyond the scope of the representation. *See In re Consupak, Inc.*, 87 B.R. 529, 549-51 (N.D. Ill. 1988) (ethical standards suggest that a responsible attorney is not "a passive observer who can remain silent in the face of a client's legally unacceptable decisions"); *Daugherty v. Runner*, 581 S.W.2d 12, 17 (Ky. App. 1978) ("an attorney cannot completely disregard matters coming to his attention which should reasonably put him on notice that his client may have legal problems or remedies that are not precisely or totally within the scope of the task being performed by the attorney"); *Darby & Darby P.C. v. VSI Int'l Inc.*, 678 N.Y.S.2d 482 (N.Y. Sup. 1998) (jury question as to whether lawyers had duty to advise client, without being asked, about availability of insurance coverage for litigation costs). This may particularly true of in-house counsel, but outside counsel who learn of potential misconduct, even if beyond the scope of their representation, run a substantial risk if they do not at least flag the issue for their client.

Allegations of failures by counsel to investigate became more common as litigation arose from the savings and loan crisis in the late 1980's and early 1990's. In *FDIC v. Clark*, 978 F.2d 1541 (10th Cir. 1992), outside counsel was found liable for negligence and other common law violations for failure to investigate allegations of wrongdoing. The counsel, which served as registered agent for a bank, was served with a complaint by borrowers against the bank accusing it and its president of involvement in a money-laundering scheme involving fraudulent loans. Counsel questioned the bank's president, who said the complaint involved a misunderstanding between borrowers and would be resolved. Counsel also reported on the lawsuit to the board of directors, summarizing it from the president's point of view but providing a copy of the complaint to the chairman of the board. The board saw no need for action, and the scheme continued for another two months. The bank later became insolvent, and the FDIC sued the outside counsel for breach of duties owed to the bank to protect it from the president's fraud. A jury verdict in favor of the FDIC was upheld on appeal. In *FDIC v. O'Melveny & Meyers*, 969 F.2d 744 (9th Cir. 1992), *rev'd*, 114 S.Ct. 2048 (1994), *on remand*, 61 F.3d 17 (9th Cir. 1995) (reaffirming earlier conclusions), the court held that an attorney has an obligation to its client, and to its client's successor in interest, to protect its client against liability which may flow from the promulgation of false or misleading information to investors; this obligation may include a duty by the attorney to investigate and disclose wrongdoing. *See also FDIC v. Benjes*, 815 F. Supp. 1415, 1416 (D. Kan. 1993) (director and legal counsel of bank was sued by receiver for, among other things, failing to recognize improper conduct or report it to disinterested directors and officers, and failure to advise board of directors to obtain outside counsel to review a questionable line of credit).

As with corporate management, a failure by counsel to investigate could give rise to an allegation that counsel deliberately avoided discovery of misconduct and that this is evidence of wrongful intent. *See Wyle v. R.J. Reynolds Industries, Inc.*, 709 F.2d 585, 590 (9th Cir. 1983) (complaint dismissed as sanction for failure to comply with discovery; plaintiff's counsel's failure to investigate plaintiff's denial of rebating was equivalent to knowledge of truth and deliberate deception of court).

If outside counsel are sued by management or its successors for failure to investigate, it may sometimes be a defense that management itself participated in the wrongful conduct. *See FDIC v. Ernst & Young*, 967 F.2d 166, 169-70 (5th Cir. 1992) (FDIC subject to same tort defenses as any other assignee); *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449, 453-57 (7th Cir. 1982) (independent auditors not liable to new management for failure to detect previous management's inflation of inventories), *cert. denied*, 459 U.S. 880 (1982); *Breezevale Ltd. v. Dickinson*, 879 A.2d 957, 962-967 (D.C. 2005) (dismissal of action and sanctions appropriate where management brought legal malpractice claim for failure to investigate in an effort to hide corporate wrongdoing). *But see FDIC v. Clark*, 978 F.2d 1541 (10th Cir. 1992) (outside counsel held liable for malpractice for failure to investigate, despite management's involvement in misconduct and assurances to counsel that problem was not significant); *O'Melveny & Meyers*, 969 F.2d at 749-52 (FDIC claims against law firm not precluded by wrongdoing of corporate officers), *rev'd*, 114 S.Ct. 2048 (1994), *on remand*, 61 F.3d 17 (9th Cir. 1995) (reaffirming earlier conclusions).

III. Reporting Misconduct

The corporation and investigating counsel must be sensitive to potential obligations to report conclusions to higher authorities in the organization where lower authorities do not take appropriate action and where future harm may result. Executives of the organization who become aware of wrongdoing may have fiduciary or other duties to report the wrongdoing to their superiors or to the Audit Committee or other committee of the Board of Directors. In addition, lawyers have additional reporting obligations. Model Rule of Professional Responsibility 1.13 establishes a general duty on the part of a lawyer to act in the best interest of the organization, including reporting a matter to higher authority when the lawyer knows that an officer or employee will act or has acted in violation of a legal obligation to the organization or in violation of law that can be imputed to the organization.

With respect to attorneys who practice before the SEC (broadly defined to include attorneys who provide advice relating to securities laws regarding any document the attorney has notice will be submitted to the SEC), Section 307 of Sarbanes-Oxley provides that the SEC shall issue a rule requiring an attorney to report material breaches of securities laws or fiduciary duty to the CEO or Chief Legal Counsel, and if no appropriate response is given, the audit committee of the board of directors or the board itself. 15 U.S.C. 7245. Under the SEC Rule, codified at 17 C.F.R. 205, "material" means "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." 17 C.F.R. 205.2(e). If the person, committee or board that conducts the report concludes that a material violation has occurred, is occurring or is about to occur, it must take reasonable steps to cause the company to adopt appropriate remedial measures and/or sanctions, including appropriate disclosures. 17 C.F.R. 205.6. (As an alternative reporting mechanism, if the company has taken the unusual step of establishing a Qualified Legal Compliance Committee (QLCC), the reporting attorney or chief legal officer may report the matter to the QLCC and need not then take any further steps to satisfy his or her obligations. 17 C.F.R. 205.3(c).) Furthermore, SEC Rules identify several circumstances in which an attorney may, but is not required to, disclose confidential information to the SEC or other applicable agency, including preventing fraud or a violation of rules that would substantially injure the issuer, 17 C.F.R. 205.3(d), although potentially conflicting state ethics rules should also be consulted in such situations.

JANUARY 2016

COMMENTARY

Department of Labor Attempts to Take Broad View of Joint Employment Status

On January 20, 2016, the U.S. Department of Labor's Wage and Hour Division issued Administrator's Interpretation No. 2016-1, which the agency describes as guidance for employers on joint employment under the Fair Labor Standards Act and Migrant and Seasonal Agricultural Worker Protection Act. In a blog post accompanying the new guidance, Dr. David Weil, administrator of the Wage and Hour Division, notes that joint employment "has been a major focus for the Wage and Hour Division in recent years" and the agency "considers joint employment in hundreds of investigations every year." Still, according to Dr. Weil, the new guidance "reflects existing policy." Thus, while the DOL's apparent focus on its enforcement agenda may be a cause for some concern, the guidance also makes clear—at least in the DOL's view—that the joint employer rules of the FLSA and MSPA remain unchanged.

The new guidance emphasizes the DOL's view that "[t]he scope of employment relationships subject to the protections of the FLSA and MPSA is broad," with the two statutes analyzed in tandem because they share an identical definition of the term "employ." That is, the DOL contends that the concepts of employment and joint employment under the FLSA and MSPA are notably broader than the common law concepts of employment and joint employment, which look to the amount of control that an employer exercises over an employee.

Thus, in the DOL's view, the test for joint employment under the FLSA and MSPA is different than the test under other labor statutes, such as the National Labor Relations Act, 29 U.S.C. 151 et seq., and the Occupational Safety and Health Act, 29 U.S.C. 651 et seq.

The guidance then discusses two primary types of joint employment relationships: "horizontal" and "vertical."

Horizontal Joint Employment

Horizontal joint employment focuses on the relationship between the two potential joint employers. According to the guidance, horizontal joint employment "may exist when two (or more) employers each separately employ an employee and are sufficiently associated with or related to each other with respect to the employee." In this type of joint employment, "there is typically an established or admitted employment relationship between the employee and each of the employers, and often the employee performs separate work or works separate hours for each employer."

Examples of horizontal joint employment, according to the guidance, may include separate restaurants that share economic ties and have the same manager controlling both restaurants or home health care providers that share staff and have common management. The guidance discusses the legal test for determining whether a horizontal joint employment relationship exists, which focuses on the degree of association between the putative joint employer, and states that the following may be relevant when analyzing this issue:

- who owns the potential joint employers (i.e., does one employer own part or all of the other or do they have any common owners);
- whether the potential joint employers have any overlapping officers, directors, executives, or managers;
- whether the potential joint employers share control over operations (e.g., hiring, firing, payroll, advertising, overhead costs);
- if the potential joint employers' operations are inter-mingled (for example, is there one administrative operation for both employers, or does the same person schedule and pay the employees regardless of which employer they work for?);
- if one potential joint employer supervises the work of the other;
- whether the potential joint employers share supervisory authority for the employee;
- whether the potential joint employers treat the employees as a pool of employees available to both of them;
- if the potential joint employers share clients or customers; and
- whether there are any agreements between the potential joint employers.

Vertical Joint Employment

Vertical joint employment, by contrast, focuses on the employee's relationship with the potential joint employer and whether that employer jointly employs the employee. According to the guidance, such a relationship may exist where the employee, "with regard to the work performed for the intermediary employer, [is] economically dependent on another employer." By way of example, the guidance lists a construction worker who works for a subcontractor but is jointly employed by a general contractor as well as a farm worker who works for a farm labor contractor but is jointly employed by the grower.

The guidance, in its discussion of the legal test to determine whether a vertical joint employment relationship exists, reflects yet again the DOL's position that joint employment should be defined as broadly as possible. The DOL takes the position that an "economic realities" test must apply, and the analysis "cannot focus only on control" (such as the power to hire and fire, supervision and control of conditions or work schedules, determination of rate and method of pay, and maintenance of employment records). Rather, the "core question" is whether the employee is economically dependent on the potential joint employer who, via an arrangement with the intermediary employer, is benefitting from the work. The guidance notes that the following seven factors are probative of the question:

Directing, Controlling, or Supervising the Work Performed. To the extent that the work performed by the employee is controlled or supervised by the potential joint employer beyond a reasonable degree of contract performance oversight, such control suggests that the employee is economically dependent on the potential joint employer.

Controlling Employment Conditions. To the extent that the potential joint employer has the power to hire or fire the employee, modify employment conditions, or determine the rate or method of pay, such control indicates that the employee is economically dependent on the potential joint employer.

Permanency and Duration of Relationship. An indefinite, permanent, full-time, or longterm relationship by the employee with the potential joint employer suggests economic dependence. This factor should be considered in the context of the particular industry at issue.

Repetitive and Rote Nature of Work. To the extent that the employee's work for the potential joint employer is repetitive and rote, is relatively unskilled, and/or requires little or no training, those facts indicate that the employee is economically dependent on the potential joint employer.

Integral to Business. If the employee's work is an integral part of the potential joint employer's business, that fact indicates that the employee is economically dependent on the potential joint employer.

Work Performed on Premises. The employee's performance of the work on premises owned or controlled by the potential joint employer indicates that the employee is economically dependent on the potential joint employer.

Performing Administrative Functions Commonly Performed by Employers. To the extent that the potential joint employer performs administrative functions for the employee, such as handling payroll, providing workers' compensation insurance, providing necessary facilities and safety equipment, housing, or transportation, or providing tools and materials required for the work, those facts indicate economic dependence by the employee on the potential joint employer.

The economic realities factors applied vary somewhat, depending on the court, but any formulation must address the "ultimate inquiry" of economic dependence.

The guidance explicitly rejects court decisions—including a decision of the U.S. Court of Appeals for the Third Circuit—analyzing only on a potential joint employer's control over the worker in question, rather than the full picture of the economic relationship among the parties. Not only that, the guidance indicates that a specific "economic realities" test from the MSPA regulations can and should be applied to claims under the FLSA. The test from the MSPA regulations, although specific to determining joint employment status in the "context of a farm labor contractor acting as an intermediary employer for a grower," can serve as "useful guidance" to determine vertical joint employment in FLSA cases. The guidance explains that the MSPA regulations can be applied beyond the particular circumstances of the MSPA because they "are probative of the core question of whether an employee is economically dependent on the potential joint employer who ... is benefitting from the work."

Significance for Employers

The timing of the joint employment guidance, issued near the first of the year and only six months after the DOL issued Administrator's Interpretation No. 2015-1, which focused on the classification of "employees" under the FLSA, further demonstrates the DOL's intent to showcase its activism with respect to wage and hour compliance. The guidance and accompanying materials, including the agency's announcement directing readers to a new DOL webpage on joint employment issues, contain numerous references to the need to hold "all responsible employers" accountable.

The agency also signals where its enforcement efforts may be directed in the future. Dr. Weil's blog post lists a number of industries, including construction, agricultural, janitorial, distribution and logistics, hospitality, and staffing, where it is more common for employees to be shared or where there are third-party management companies.

The guidance makes clear that the agency is well-aware of practical as well as legal considerations with respect to joint employment: "[W]here joint employment exists, one employer may be larger and more established, with a greater ability to implement policy or systematic changes to ensure compliance." "Thus," it continues, "WHD may consider joint employment to achieve statutory coverage, financial recovery, and future compliance." In other words, the DOL should be expected to factor a number of practical considerations into its investigations, including—and perhaps foremost—the ability to pay large monetary settlements or judgments. As the guidance notes, joint employers are jointly and severally liable under both statutes.

Finally, in a footnote, the agency exhibits its skepticism of contractual provisions that purport to disclaim joint employer liability. Many employers, especially those that use staffing agencies or similar third-party entities, regularly include such terms in their contracts. As the guidance highlights, these clauses may face special scrutiny and are "not relevant to the economic realities of the working relationship." These clauses are often drafted to state that an employer does not direct or control workers provided by a third party. However, in light of the DOL's rejection of the legal tests that look exclusively or primarily to a putative joint employer's control over the worker, companies cannot rely solely on such contract terms to mitigate potential liability. Instead, employers should carefully analyze how these relationships work in practice.

Overall, the guidance is useful insofar as it clearly states the DOL's stance on how to determine joint employment status. However, given the complexity of joint employment doctrine across the spectrum of federal and state employment law, it is unlikely that the guidance will become a primary resource for large and sophisticated employers. Rather, the guidance may best be viewed as further evidence of the DOL's intent to cast its enforcement net as widely as possible. As Dr. Weil stated in his blog post, the agency plans to "continue educating employers about their responsibilities," perhaps indicating that employers should expect additional guidance on other topics to be published in the near future.

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ALERT

National Labor Relations Board Adopts Expansive New Joint Employer Standard

August 2015

In a highly anticipated decision, the National Labor Relations Board (the "Board" or "NLRB") reversed more than 30 years of established precedent and liberalized the standard for determining whether two or more entities are joint employers for purposes of the National Labor Relations Act (the "Act"). *Browning-Ferris Indus. of Cal., Inc.*, 362 NLRB No. 186 (Aug. 27, 2015). Since 1984, the NLRB has required proof of a significant or substantial degree of "direct and immediate" control, not merely potential control, by a putative joint employer over the hiring, firing, discipline, supervision, and direction of employment of another company's employees before finding that a joint employer relationship exists. However, in *Browning-Ferris Indus. of Cal., Inc.*, the Board, in a 3-to-2 decision, substantially modified that standard to lower the evidentiary threshold necessary to establish a joint employer relationship for purposes of the Act. It held:

"[T]he Board may find that two or more statutory employers are joint employers of the same statutory employees if they "share or codetermine those matters governing the essential terms and conditions of employment." In determining whether a putative joint employer meets this standard, the initial inquiry is whether there is a common-law employment relationship with the employees in question. If this common-law employment relationship exists, the inquiry then turns to whether the putative joint employer possesses sufficient control over employees' essential terms and conditions of employment to permit meaningful collective bargaining."

Id. at 2 (internal citation omitted). The NLRB majority explained that "central to both of these inquiries is the existence, extent, and object of the putative joint employer's control." *Id.* The majority proceeded to substantially relax the level of control that a putative employer needs to exert to establish a joint employer relationship:

"We will no longer require that a joint employer not only *possess* the authority to control employees' terms and conditions of employment, but also *exercise* that authority. Reserved authority to control terms and conditions of employment, even if not exercised, is clearly relevant to the joint-employment inquiry…. Nor will we require that, to be relevant to the joint-employer inquiry, a statutory employer's control must be exercised directly and immediately. If otherwise sufficient, control exercised indirectly—such as through an intermediary—may establish joint-employer status."

Id. (emphasis in original). In so holding, the Board explicitly overruled several well-established cases including *Laerco*, *TLI*, and *Airborne Express*. *Id.* at 16. The Board relied heavily on the recent growth of the contingent workforce (e.g., staffing and subcontracting arrangements) to justify its departure from these precedents. *Id.* at 11. Thus, in the majority's view, its decision advances the Act's policy of encouraging collective bargaining because its redefined joint employer standard accounts for "the full range of employment relationships wherein meaningful collective bargaining is, in fact, possible." *Id.* at 13.

A joint employer finding has the potential to greatly affect such businesses since the consequences of a joint employer finding by the Board include, but are not limited to:

- Conferring joint and several liability on both companies for unfair labor practices committed by the direct employer, including both monetary and injunctive relief;

- Requiring a company to engage in collective bargaining with, and provide access to information to, labor organizations representing the direct employer's employees; and
- Allowing union activity on the property of a business (e.g., picketing, boycotting) that would otherwise be considered unlawful secondary activity in violation of Section 8(b)(4) of the Act.

The *Browning Ferris Indus. of Cal.* case involved a representation petition filed by the Teamsters union seeking to represent approximately 240 employees of a supplier, Leadpoint, who provided contract labor to staff a waste recycling plant operated by Browning-Ferris Industries ("BFI"). Initially, the NLRB's Regional Director concluded that the employees covered by the union's petition were Leadpoint employees, not employees of BFI. In reversing the Regional Director's decision, the Board concluded that BFI and Leadpoint were joint employers of the Leadpoint employees, notwithstanding substantial evidence demonstrating that BFI did not share, or co-determine, those matters governing the essential terms and employment of those Leadpoint employees:

- "BFI and Leadpoint employ separate supervisors and lead workers at the facility." *Id.* at 3.
- "The Agreement between BFI and Leadpoint provides that Leadpoint will recruit, interview, test, select, and hire personnel to perform work for BFI. BFI managers … testified that they are not involved in Leadpoint's hiring procedure and have no input into Leadpoint's hiring decisions." *Id.*
- Leadpoint determines the wages and benefits to provide its employees. *Id.* at 4.
- "Leadpoint alone schedules which employees will work each shift…." *Id.*

In concluding that BFI and Leadpoint were joint employers, the NLRB majority largely disregarded these facts and instead emphasized the following ways in which BFI had some involvement in the employment of Leadpoint's employees:

- "Although BFI does not participate in Leadpoint's day-to-day hiring process … BFI retains the right to reject any worker that Leadpoint refers to its facility." *Id.* at 18.
- "Although Leadpoint is responsible for selecting the specific employees who will work during a particular shift, it is BFI that makes the core staffing and operation decisions that define all employees' work days." *Id.* at 19.
- "Under the parties' contract, Leadpoint determines employees' pay rates, administers all payments, retains payroll records, and is solely responsible for providing and administering benefits. But BFI specifically prevents Leadpoint from paying employees more than BFI employees performing comparable work … In addition, BFI and Leadpoint are parties to a cost-plus contract, under which BFI is required to reimburse Leadpoint for labor costs plus a specified markup." *Id.*

As a result of that finding, if the union prevails in the representation election, both BFI and Leadpoint will be required to bargain with Teamsters over the terms and conditions of employment for the Leadpoint employees.

In a scathing nearly 30-page dissent, Members Miscimarra and Johnson attacked what they referred to as "the most sweeping of recent major decisions" and argue that "the Board majority rewrites the decades-old test for determining who the 'employer' is." *Id.* at 21. The dissent noted:

"This [decision] will subject countless entities to unprecedented new joint-bargaining obligations that most do not even know they have, to potential joint liability for unfair labor practices and breaches of collective-bargaining agreements, and to economic protest activity, including what have heretofore been unlawful secondary strikes, boycotts, and picketing…."

"This new test leaves employees, unions, and employers in a position where there can be no certainty or predictability regarding the identity of the "employer…."

"The number of contractual relationships now potentially encompassed within the majority's new standard appears to be virtually unlimited: insurance companies that require employers to take certain actions with employees in order to comply with policy requirements of safety, security, health, etc.; [f]ranchisors; [b]anks or other lenders whose financing terms may require certain performance measurements; [a]ny company that negotiates specific quality or product requirements; [a]ny company that grants access to its facilities for a contractor to perform services there…; [a]ny company that is concerned about the quality of the contracted services; [and] [c]onsumers or small businesses who dictate times, manner, and some methods of performance of contractors." *Id.* at 21-37.

Companies should take note of the majority's definition of "joint employer" and evaluate how it may affect their operations. If a company is found to be a joint employer, it may be subjected to statutory collective bargaining obligations with respect to their contracting partners' employees as well as liability for unfair labor practices committed by those businesses with which they contract. Businesses could also be subject to picketing, boycotts, and other protest activities that, absent the joint employer finding, would otherwise be unlawful secondary activity.

Businesses should continue to monitor developments in the Board's joint employer standard, since the new standard is inconsistent with the joint employer standard in other contexts such as Title VII and the Fair Labor Standards Act, and it is unclear whether a circuit court, if presented with an opportunity to review the revised standard, will uphold it.

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Got Derivatives?

Take Care to Avoid These Five Target Areas of Exchange Enforcement Efforts

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A variety of companies use futures exchanges to hedge risk. A company may do so, for example, because its business exposes it to interest rate, foreign exchange or price risk for the commodities used in its manufacturing processes. As a market participant who does not speculate on price changes, a hedger may suffer from a false sense of regulatory enforcement "security." However, hedgers are exposed to the same regulatory enforcement risk as speculators. Yet, speculators may better appreciate the risk of regulatory exposure. Failure to appreciate the regulatory risks can cause companies to be caught off-guard when enforcement staff from the exchanges or governmental regulators come knocking. It is best to know the pitfalls and avoid them before a problem arises.

The U.S. Commodity Futures Trading Commission ("CFTC") is the primary regulator of the commodities and derivatives markets. Its ability to enforce provisions of the Commodity Exchange Act ("CEA") is well known and the penalties for violations can be severe. However, in the last two years, the CME Group of exchanges (i.e., CME, CBOT, NYMEX and COMEX) and the Intercontinental Exchange ("ICE") have stepped up enforcement of their respective exchange rules. By becoming frontline enforcers, the exchanges are catching activities that may have gone unnoticed or unpunished in the past. Notably, there are five particular areas of market conduct being investigated and punished with increasing regularity.

1. Sharing of Unique Identifiers for Direct Trading

ICE and the CME Group require individuals entering orders into their respective electronic trading platforms to have unique identifiers or user IDs. This identification allows the exchanges to determine who is entering orders and who to contact if there are questions about trading activity. ICE and the CME Group have prohibitions regarding the sharing of user IDs. ICE Rule 27.09(b) prohibits allowing a person to use another's Authorized Trader ID to enter orders on the ICE Trading Platform. Similarly, CME Rule 576 prohibits use of another's operator ID, also referred to as a "Tag 50 ID," when entering orders on the CME Globex platform[1].

Improper use of another's trader ID is low hanging fruit for the exchanges. In the last two years, the CME Group brought several disciplinary actions for entering, or allowing to be entered, orders on CME Globex using incorrect or borrowed Tag 50 IDs[2]. While the fines for these avoidable violations are not typically significant, it is best to avoid investigations of small matters which can, and often do, lead to the discovery of more egregious violations.

[1] The requirements differ for orders entered by an automated trading system and for orders entered manually. See CME Group Market Regulation Advisory Notice RA0915-5 – Operator ID ("Tag 50 ID") Required on All CME Globex Orders (Dec. 16, 2009).

[2] *E.g., In the Matter of Yongwu Shao*, NYMEX 13-9416-BC (Oct. 2, 2015); *In the Matter of Morgan Stanley & Co. LLC*, CME 12-9089-BC and 13-17469-BC (Nov. 20, 2014); *In the Matter of Jilin Grain Group Import and Export Co., Ltd.*, CBOT 12-9031-BC (Sept. 22, 2014).3 United States v. Kovel, 296 F.2nd 918 (2d Cir. 1961).

[3] ICE Rule 4.02(c); CME Rule 534; *see also In the Matter of San Diego Gas & Electric Company*, CFTC Docket No. 10-08, p. 3 (Apr. 22, 2010).

[4] CME Group Market Regulation Advisory Notice RA1411-5RR – Wash Trades Prohibited, pg. 3 (Jan. 6, 2015).

[5] See id

2. Wash Trades

Wash trades are prohibited by the exchanges and are considered "grave" matters by the CFTC[3]. A wash trade is the purchase or sale of the same instrument at the same, or similar, price for beneficially owned accounts[4]. Intent of the parties to the transaction is measured by whether they knew, or reasonably should have known, the transaction[5] would result in a wash result. Intent can be inferred from the circumstances, including the structure and execution of the transaction. The hallmarks of a wash trade are lack of risk and the absence of intent to take a *bona fide* market position.

Even though wash trades are sometimes done for reasons other than attempting to influence a market price, they are still prohibited. There are numerous examples of wash trades being done to move positions between affiliated entities, offset positions or transfer equity[6]. Occasionally, wash trades are done simply to move a position that was assigned to the wrong account[7]. Although unlawful, these transactions are relatively easy to accomplish, but the exchanges are equally adept at identifying them. The desire for a wash result should not outweigh the desire to avoid a regulatory investigation. Those executing transactions must be mindful that washing trades is prohibited for any reason. To facilitate compliance, self-match prevention tools are available to help thwart intentional and inadvertent wash trades.

3. Exchange for Related Position Transactions

Exchange for Related Position ("EFRP") transactions are off-exchange privately negotiated trades that are subsequently submitted to the exchange[8]. An Exchange for Physical ("EFP") transaction is a type of EFRP that is a simultaneous exchange of a physical or cash position for a corresponding futures position. For an EFP to be permissible, the rules require a *bona fide* transfer of ownership of the cash position and the accounts involved must be independently controlled[9]. Parties attempting to execute *bona fide* EFPs would be well advised to review the requirements of the applicable exchange before transacting.

The use of EFPs for non-*bona fide* reasons is a concern. Similar to non-manipulative wash trades, EFPs can accomplish the movement of positions between commonly controlled accounts or affiliates without transacting on an exchange. In those instances, the EFP lacks the cash component to the transaction[10]. EFPs should not be looked at as attractive alternatives to wash trades. The exchanges are well equipped to identify improper EFPs, particularly where the counterparties are the same or similar. For those wishing to move positions, be wary of any advice suggesting the use of an EFP and consult the relevant exchange's rules regarding transfer transactions[11].

4. Making False Statements to the Exchange

Both ICE and the CME Group prohibit persons from making false statements to the exchanges[12]. Not only can exchanges take action for these violations, but the CFTC has shown a propensity to charge persons and companies with violations of the CEA for making false statements to registered entities, such as ICE and the CME Group exchanges[13].

It is never a good idea to lie to, or mislead, a regulator. Nevertheless, when an exchange has questions about activity in its markets, it is not uncommon for the exchange to identify the person involved through the user ID and contact the person directly. Concerned about having done something wrong, the person may attempt to "fix" the problem by making false statements. The company may not even be aware that the employee was contacted until the informal inquiry made to the individual becomes an investigation of the company. Consequently, it should be clearly understood by all employees that any inquiries from an exchange or governmental regulator be brought to the attention of legal or compliance personnel immediately. No response should be given until such time as a coordinated and accurate one can be provided by the company.

5. Disruptive Trading

A concern for any company that trades should be whether orders are placed on an exchange without the intent to execute. In the last two years, the CME Group and ICE implemented rules specifically prohibiting entering orders with the intent to cancel or modify before execution[14]. This type of activity can take several forms, including (i) entering and cancelling orders during the pre-opening period for the purpose of identifying order book depth and (ii) entering large orders to encourage market participants to trade opposite smaller resting orders on the other side of the book. In the latter scenario, the large orders are cancelled after the smaller orders are filled. Recent enforcement actions suggest that the exchanges are committed to prohibiting this conduct[15]. The message is clear – entering orders with the intent, at the time of order entry, to cancel before execution is a pitfall to be avoided.

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These are just five areas of potential enforcement exposure for hedgers and speculators. The exchange rulebooks are robust and there are other ways to run afoul. But, by knowing where the traps are, companies can avoid problems and prevent the dreaded knock at the door. ●

[6] *E.g., In the Matter of Rajasekaran Veeramuthu*, COMEX 12-9204-BC (Oct. 12, 2015); *In the Matter of Peter Birch*, COMEX 14-9730-BC (Oct. 2, 2015); *In the Matter of Jilin Grain Group Import and Export Co., Ltd.*, CBOT 12-9031-BC (Sept. 22, 2014); *In the Matter of Tower Research Capital Investments LLC*, CME 11-8056-BC (Sept. 22, 2014; *In the Matter of Merrill Lynch Commodities Europe Limited*, NYMEX 13-9457-BC (Feb. 2, 2014).

[7] *In the Matter of Citigroup Energy, Inc.*, ICE 2013-042 (Oct. 9, 2015).

[8] See CME Rule 538; ICE Rule 4.06.

[9] See id.

[10] *E.g., In the Matter of INTL FC Stone Markets* LLC, NYMEX 14-9700-BC-1 (July 20, 2015); *In the Matter of Guardian Int.'l Gold Corp.*, COMEX 12-9009-BC (Feb. 24, 2014); *In the Matter of Lehman Brothers Inc.*, CBOT 2007-MSR-003 (Jan. 4, 2008).

[11] See ICE Rule 4.11; CME Rule 853.A.

[12] See ICE Rule 4.12; CME Rule 432.L.2.

[13] See *CFTC v. Royal Bank of Canada*, Case No. 12-cv-02497 (S.D.N.Y. Oct. 17, 2012); CFTC v. David M. Numm, Case No. 12-cv-7786 (S.D.N.Y. Oct. 18, 2012).

[14] See ICE Rule 4.02(l)(1)(A); CME Rule 575.

[15] *E.g., In the Matter of Nitia Gupta*, NYMEX 13-9391-BC (Oct. 12, 2015); *In the Matter of Edward Turanzas*, COMEX 14-0055-BC (Oct. 12, 2015); *In the Matter of Danny Giamalis*, CME 10-7845-BC (Sept. 22, 2014).

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PREPARING FOR THE SQUALL: THE COMING MARGIN REQUIREMENTS FOR OTC DERIVATIVES

Rules proposed by the Prudential Regulators and the CFTC impose requirements on swap dealers and major swap participants to post and collect margin in connection with their OTC derivatives trades with each other and financial entities. The authors discuss these proposed rules, along with recommendations made by IOSCO, and review how they will impact other market participants — so-called "end-users" — of OTC derivatives.

By James M. Cain and Meltem F. Kodaman *

The once largely unregulated over-the-counter ("OTC") market for derivatives trading has changed dramatically since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). While the regulations that have been adopted to implement the Dodd-Frank Act have most fundamentally impacted swap dealers, all market participants have had to navigate through waves of new requirements, including more rigorous recordkeeping practices, reporting of their transactions to swap data repositories, substantial amendments to trading documentation, and changes to their overall trading practices, which include mandatory central clearing of certain derivative transactions. Meanwhile, another regulatory storm that will cause a major shift in market practice looms on the horizon: the finalization of margin rules for OTC swap transactions. These rules will obligate swap dealers, major swap participants, and certain financial institutions, including banks, insurers, and investment funds, to post and collect margin in connection with their OTC swap transactions.

The Prudential Regulators[1] and the Commodity Futures Trading Commission ("CFTC") each published re-proposed margin rules (collectively, the "Margin Rules") in the second half of 2014. Although these rules have not yet been finalized and there may be some revisions to the proposals based on public comments, the overarching requirement that swap dealers and major swap participants ("covered swap entities")[2] post and

[1] The "Prudential Regulators" are U.S. bank regulators, and include the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Housing Finance Agency, and the Farm Credit Administration.

[2] For ease of reference in this article, we refer to all entities directly subject to the Margin Rules as "covered swap entities." Note, however, that the term "covered swap entity" is defined differently in the rules proposed by the Prudential Regulators and the CFTC. Both encompass swap dealers and major swap participants, but the Prudential Regulators' margin rules apply

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collect margin from each other and certain specified financial institutions in connection with their OTC swap transactions will not change. Certain of these requirements would become effective as early as December 1, 2015, though it is likely the effective date will be postponed by at least nine months, as discussed further below. Market participants should familiarize themselves with the requirements of the proposed rules, including resultant changes to trading documentation, as soon as possible.

Although the Margin Rules and recent legislation generally exclude non-financial end-users from the requirement to post and collect margin,[3] such entities should be aware that covered swap entities will continue to consider requiring margin due to credit or overall risk concerns. In addition, financial entities subject to new capital requirements under the international regulatory framework for banks known as Basel III,[4] and non-bank swap dealers that are subject to the CFTC's proposed capital requirements, may have a decreased appetite for entering into uncollateralized swap transactions, since such entities may be penalized under the relevant capital rules for doing so. In summary, it is anticipated that the margin requirements, particularly when coupled with capital requirements imposed on banks and swap dealers, will have a significant impact on liquidity, transaction pricing, netting of exposures, and documentation for both financial and non-financial market participants.

THE PROPOSED MARGIN RULES

The Prudential Regulators initially proposed margin rules in April 2011;[5] however, as a result of comments received from the public, and subsequently recommended standards for margin requirements by the International Organization of Securities Commissions and the Basel Committee on Banking Supervision,[6] the Prudential Regulators re-proposed their rules in September 2014 (the "PR Proposed Rule").[7] The PR

footnote continued from previous page…

only to swap dealers and major swap participants (including security-based swap dealers and security-based major swap participants) regulated by one of the Prudential Regulators, whereas the CFTC's margin rules apply to such entities that are *not* regulated by a Prudential Regulator or the Securities and Exchange Commission ("SEC").

[3] Although unrelated to the federal terrorism risk insurance program, non-financial end-users have been afforded exemptive treatment under the recently passed Terrorism Risk Insurance Program Reauthorization Act of 2015 from the provisions in the Commodity Exchange Act that require swap dealers and major swap participants to collect margin from their counterparties to non-cleared swap transactions. *See* https://www.congress.gov/114/bills/hr26/BILLS-114hr26eh.pdf at 68-70 and a legal alert on this topic by Sutherland *at* http://www.sutherland.com/NewsCommentary/Legal-Alerts/169568/Legal-Alert-Congress-Exempts-Non-Financial-End-Users-Their-Agents-and-Certain-Cooperatives-From-Non-Cleared-Swap-Margin-Requirements-in-Reauthorization-of-Terrorism-Insurance-Bill. Note that the legislation mandates that regulators must adopt regulations to implement the exemption.

[4] Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems, *available at* http://www.bis.org/publ/bcbs189.pdf.

[5] Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27,564, 27,566 (May 11, 2011) (margin is required to be collected by swap dealers under § 731 of the Dodd-Frank Act and these rules are in response to that requirement).

[6] The International Organization of Securities Commissions ("IOSCO") and the Basel Committee on Banking Supervision ("BCBS"), in consultation with the Committee on Payment and Settlement Systems and the Committee on the Global Financial System, formed the Working Group on Margining Requirements in October 2011 to develop a proposal on margin requirements for non-centrally cleared derivatives. In July 2012, an initial proposal was released for consultation (*available at* http://www.bis.org/publ/bcbs225.pdf). On Feb. 15, 2013, the BCBS and IOSCO issued a Second Consultative Document (*available at* https://www.bis.org/publ/bcbs242.pdf) that represents a near-final proposal on margin requirements for non-centrally cleared derivatives. On September 2, 2013, the final report was issued (the "Final IOSCO Report") (*available at* http://www.bis.org/publ/bcbs261.pdf). The Final IOSCO Report reflects the continuing efforts of regulators worldwide to adopt and implement a coordinated margin regime across jurisdictions.

[7] Margin and Capital Requirements for Covered Swap Entities, 79 Fed. Reg. 57,347 (proposed Sept. 24, 2014).

Proposed Rule is applicable to swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants that are regulated by one of the Prudential Regulators.

Like the Prudential Regulators, the CFTC initially proposed margin rules for swap dealers and major swap participants in 2011,[8] followed by a re-proposal in October 2014 (the "CFTC Proposed Rule").[9] Because the CFTC Proposed Rule will only apply to those swap dealers and major swap participants that are not subject to regulation by one of the Prudential Regulators or the SEC,[10] such rules will primarily apply to non-bank swap dealers and major swap participants.[11] As further discussed below, both the PR Proposed Rule and the CFTC Proposed Rule will impact other market participants who trade with the covered swap entities, including financial institutions and many end-users.

The PR Proposed Rule and the CFTC Proposed Rule are largely and purposefully consistent with each other so as to ensure that both bank and non-bank covered swap entities are subject to generally the same margin requirements. Both sets of rules address initial margin, which is an amount required to be posted to a counterparty over and above the market value of the relevant transaction to cover potential future exposures (and models to calculate such amounts), as well as variation margin, which is an amount that is posted to cover existing exposure in connection with the mark-to-market value of the transaction. Both rules also echo many, but not all, of the recommendations made in the Final IOSCO Report, as discussed further below. The Final IOSCO Report was intended to ensure that margin requirements in connection with OTC derivative transactions are relatively uniform on a global basis, though it does not mandate that countries adopt its recommendations.

WHO HAS TO POST AND COLLECT COLLATERAL?

The Margin Rules require that covered swap entities post margin to, and collect margin from, certain of their counterparties in connection with OTC swaps.[12] Whether a market participant must post collateral depends upon its categorization under the rules and overall exposure with any given counterparty on a consolidated basis, as discussed below. The Final IOSCO report also emphasizes the formal categorization of market participants, specifically that national regulators provide precise definitions of "financial firms," "non-financial firms," and "systemically important non-financial firms."[13]

The Margin Rules categorize market participants as follows:

- Covered Swap Entities
  - "Covered swap entities" under the PR Proposed Rule are banks or other financial institutions subject to Prudential Regulator supervision that are swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants.[14]
  - "Swap Dealers" or "Major Swap Participants" under the CFTC Proposed Rule are entities that have registered with the CFTC as such, and are

[8] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (proposed Apr. 28, 2011).

[9] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 Fed. Reg. 59,898 (proposed Oct. 3, 2014).

[10] The SEC has yet to propose its rules on margin for uncleared security-based swap transactions. The SEC has jurisdiction over security-based swap dealers and major security-based swap dealers not subject to the primary jurisdiction of the Prudential Regulator or the CFTC.

[11] Although both the CFTC's and the Prudential Regulators' proposed rules apply to both swap dealers and major swap participants, for purposes of this article, we generally refer only to swap dealers since, to date, only two major swap participants have registered with the CFTC: Cournot Financial Products, a now defunct subsidiary of Morgan Stanley, and MBIA Insurance Corporation, which may be subject to a rehabilitation or liquidation proceeding in the near future, according to the parent company's 10-K filing with the SEC *at* http://www.sec.gov/Archives/edgar/data/814585/00011931251 4080397/d678198d10k.htm.

[12] Cleared swaps, like futures, require both counterparties to post both initial margin and variation margin to the applicable derivatives clearing organization or clearinghouse. For cleared swaps, such collateral must be accounted for on an individual customer basis but may be operationally commingled with, though legally segregated from, collateral posted by other customers of the same clearing member in an omnibus account. Margin above amounts to be posted to the clearing house that may be required by the clearing member can be held in segregated third-party custodial accounts if negotiated.

[13] Final IOSCO Report, *supra* note 6 at 9, *available at* http://www.bis.org/publ/bcbs261.pdf.

[14] The Prudential Regulators have the discretion to expand this list in the future.

not subject to supervision by a Prudential Regulator or the SEC.[15]

- Financial End-Users
  - "Financial end-users" under the PR Proposed Rule are a specific set of entities listed in the re-proposed rules. Such entities include, among others, non-swap dealer banks, money services businesses, Farm Credit System banks and associations, entities regulated by the Federal Housing Finance Agency,[16] public and private funds, broker-dealers, insurance companies, commodity pools, commodity trading advisors, employee benefit plans, and business development companies.
  - The definition purposefully does *not* include the "catchall" bucket contained in the definition of "financial entity" in Section 2(h)(7)(C) of the Commodity Exchange Act ("CEA"),[17] *i.e.*, an entity predominantly engaged in activities that are financial in nature (as defined in the Bank Holding Company Act).[18] However, the PR Proposed Rule affords the Prudential Regulators discretion to designate additional entities as "financial end-users."[19]
  - The definition of "Financial End-User" under the CFTC Proposed Rule largely mirrors the same definition in the PR Proposed Rule, but in some cases provides more specificity, *e.g.*, includes non-bank lenders that are state-licensed or registered and any non-US entity that would be a "financial entity" if it were organized under the laws of the U.S.
  - Both the PR Proposed Rule and the CFTC Proposed Rule create a subset of this category: financial end-users with "material swaps exposure." These entities, like covered swap entities, are required to post and collect initial margin (as discussed in further detail below) when entering into swap transactions with covered swap entities.

    "Material swaps exposure" means that these financial end-users have an average daily aggregate *notional* amount of $3 billion or more for all non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards, and foreign exchange swaps.[20] In contrast to the Margin Rules, the Final IOSCO Report recommends that such threshold for material swaps exposure be set at a notional amount of €8 billion,[21] (approximately) $9.5 billion at the current exchange rate. The CFTC noted that this amount in U.S. dollars was too high of a threshold to be useful for market risk reduction,[22] and thus, implemented the lower $3 billion threshold for materials swaps exposure. For purposes of calculating whether it has

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[15] List of Provisionally Registered swap dealers and major swap participants can be found under "Swaps Regulation," *available at* http://www.cftc.gov/LawRegulation/DoddFrankAct/index.htm.

[16] The Federal Home Loan Banks, Fannie Mae, and Freddie Mac are included in this category.

[17] A "financial entity" as defined in the Commodity Exchange Act is an entity that is not a swap dealer or major swap participant and is either: 1) a commodity pool as defined in CEA Section 1a(10); 2) a private fund as defined in Section 202(a) of the Investment Advisers Act of 1940; 3) an employee benefits plan as defined in Sections (3) and (32) of Part 3 of the Employee Retirement Income Security Act of 1974; 4) a person predominately engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in § 4(k) of the Bank Holding Company Act of 1956; 5) a person that would be a financial entity described in (1) or (2) if it were organized under the laws of the United States or any State thereof; 6) the government of any foreign country or a political subdivision, agency, or instrumentality thereof; or 7) any other person the CFTC may designate." Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732, 23,743 (proposed Apr. 28, 2011) (regarding Proposed CFTC Regulation 23.150).

[18] Bank Holding Company Act of 1956 § 4(k).

[19] Margin and Capital Requirements for Covered Swap Entities, 79 Fed. Reg. at 57,361.

[20] While they are included for purposes of calculating the "material swaps exposure" threshold, foreign exchange swaps and foreign exchange forwards will not be subject to the Margin Rules' requirements by virtue of the Secretary of the Treasury's determination to exempt such instruments from regulation as swaps (*see* http://www.gpo.gov/fdsys/pkg/FR-2012-11-20/pdf/2012-28319.pdf; *see also* a Sutherland legal alert on the topic, at http://www.sutherland.com/News Commentary/Legal-Alerts/93034/Legal-Alert-US-Treasury-Secretary-Exempts-FX-Swaps-and-FX-Forwards-From-Key-Dodd-Frank-Requirements).

[21] Final IOSCO Report, *supra* note 6, at 8.

[22] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 Fed. Reg. at 59,905-06.

- material swaps exposure, a financial end-user must take into consideration all of its and its affiliates' transactions with all counterparties.

- Other Counterparties/Non-Financial End-Users
  - Entities not falling within the "covered swap entity" or "financial end-user" categories are considered "other counterparties" for purposes of the PR Proposed Rule and "Non-Financial End-Users" in the CFTC Proposed Rule. Certain financial entities that are expressly carved out of the financial end-user category, including sovereign entities, multilateral development banks, and certain captive financing affiliates, are considered "other counterparties."[23]
  - The CFTC definition excludes not only certain captive finance companies but also affiliates that would be financial entities but for the fact that the affiliate is acting on behalf of another affiliate and as an agent, using the hedges to mitigate the commercial risk of the other affiliate that is not a financial entity (commonly known as "treasury affiliates" or "centralized hedging centers").[24]

Initial Margin

The Margin Rules require that covered swap entities and swap dealers both post *and* collect initial margin for OTC swap transactions with other covered swap entities or with financial end-users that have material swaps exposure.[25] The posting and collection of initial margin is only required if the counterparties, together with their affiliates, have an aggregate credit exposure, for OTC swaps and security-based swaps, of $65 million or more. "Aggregate credit exposure," in contrast to "material swaps exposure," which is based on notional value, is measured by the amount of initial margin that would otherwise be required to be paid to the covered swap entity or to the counterparty. In addition, unlike variation margin, initial margin is not based on the mark-to-market or other value of the positions between the counterparties; rather, initial margin is based on the potential change in value of a swap or portfolio of swaps over a specified time period. The $65 million threshold is applied on a consolidated entity level and, therefore, would apply across the OTC swaps between a covered swap entity and its affiliates and the counterparty and its affiliates.[26] The analogous threshold in the Final IOSCO Report is set at €50 million (approximately $70 million at the current exchange rate) on an aggregate basis.[27]

Initial margin must be re-calculated and paid daily, subject to a minimum $650,000 transfer amount.[28] Although initial margin requirements are unlikely to fluctuate after the initial calculation the way variation margin might, changes in the market or additional OTC trades between the parties may result in a calculation of more or less initial margin based on the model used. While re-calculation is required daily to ensure that sufficient initial margin is collateralizing the trade, practically speaking, adjustments to initial margin are not likely to be a daily occurrence.

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[23] *Id.* at 57,368.

[24] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 Fed. Reg. at 59,903. Note that both captive finance companies and agent affiliates are excluded from the definition of "financial entity" in relation to the mandatory clearing rules under the Dodd-Frank Act.

[25] Note that, other than with respect to entities regulated by the Farm Credit Administration or the Federal Housing Finance Agency, the initial proposed margin rules by the Prudential Regulators only required covered swap entities to *collect* (not *post*) initial margin from certain non-swap dealer counterparties.

[26] Note that the Margin Rules define "affiliate" as any company that controls, is controlled by, or is under common control with another company. "Control" is defined as (1) having ownership, control, or power to vote 25% or more of a class of voting securities of a company (directly or indirectly), (2) ownership or control of 25% or more of the total equity of a company (directly or indirectly), or (3) control in any manner of the election of a majority of the directors or trustees of a company.

[27] The Final IOSCO Report clarifies that investment funds managed by an investment advisor are considered distinct entities and are thus treated separately when applying the threshold. This treatment only applies if the funds are distinct legal entities that are not guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy. Final IOSCO Report, *supra* note 6.

[28] The Final IOSCO Report recommended that the minimum transfer amount should not exceed €500,000 (approximately $600,000 at the current exchange rate). A minimum transfer amount is the amount below which the parties do not need to post collateral, so as to avoid nuisance transfers of collateral. Once the minimum transfer amount is reached, a party must post the full amount of collateral required, not just the amount above the minimum transfer amount. Minimum transfer amount also includes any variation margin that is payable. Final IOSCO Report, *supra* note 6 at 10.

Initial margin may include cash and, unlike variation margin, other non-cash forms of collateral such as gold and certain government bonds, corporate bonds, and equities, subject to the Margin Rules' specified haircuts and other limits.[29] The PR Proposed Rule requires that initial margin be calculated pursuant to a model approved by a covered swap entity's Prudential Regulator or a standardized approach detailed in Appendix A to the PR Proposed Rule.[30] The CFTC Proposed Rule similarly requires that the initial margin calculation be based on a risk-based model approved by the CFTC or the standardized table method set forth in the proposed rule.[31] The standardized tables in both the Prudential Regulator and CFTC rules are identical.

The Margin Rules also impose certain segregation requirements on initial margin: any initial margin that is required to be *collected* by a covered swap entity under the rules must be segregated with a third-party custodian. Any amounts collected above and beyond the required amount need not be segregated. In contrast, *all* initial margin (*i.e.*, margin required by the rules and any excess beyond that agreed to by the parties) that is *posted* by a covered swap entity to its counterparty must be segregated with a third-party custodian.

Swap transactions entered into by financial end-users without a material swap exposure or "other counterparties" (non-financial end-users) have no set initial margin requirements under the Margin Rules, unless the covered swap entity or swap dealer determines that it must collect initial margin to address the credit risk posed by such counterparty and/or the risk of the swap transaction itself. The parties also may otherwise mutually agree to post initial margin in connection with a swap transaction.

Variation Margin

Covered swap entities must collect variation margin from, and post variation margin to, all covered swap entity and all financial end-user counterparties on a zero threshold basis,[32] regardless of whether a financial end-user has material swaps exposure. This two-way margin requirement for variation margin is also in the Final IOSCO Report.[33] Like initial margin, variation margin must be re-calculated and paid daily, and is subject to an aggregate $650,000 minimum transfer amount.[34] Variation margin is not subject to the segregation requirements under the Margin Rules and may be re-hypothecated if permitted under the parties' trading documentation.

Notably, the Margin Rules only allow for cash denominated in U.S. dollars (or the currency in which payment obligations are required to be settled under the swap) as "eligible collateral" for variation margin,[35] even though many market participants essentially include in their trading documentation the ability to post as variation margin other types of collateral, *e.g.*, U.S. Treasuries. Market participants have already raised concerns in response to the Margin Rules about this limitation, noting that it deviates from market practice and is not economic for many market participants.[36] In support of this position, commenters directed the regulators to the 1994 Credit Support Annex ("CSA") published by the International Swaps and Derivatives Association, Inc. ("ISDA"), and relevant ISDA definitions, *e.g.*, the ISDA Collateral Asset Definitions, which specifically contemplate the use of non-cash margin in connection with derivative transactions.[37] Further, the Final IOSCO Report allows for cash, high-quality government and central bank securities, high-quality corporate bonds and covered bonds, equities included in major stock indices, and gold to be posted as variation margin.[38]

If a covered swap entity enters into a swap transaction with an "other counterparty" (non-financial end-user), then it only must collect variation margin from such counterparty if it determines that the credit risk of that counterparty and the nature of the transaction require

[29] Margin and Capital Requirements for Covered Swap Entities, 79 Fed. Reg.at 57,355.

[30] *Id.* at 57,375.

[31] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 Fed. Reg. at 59,929.

[32] A "threshold" with respect to collateral generally means the amount of exposure that one party has agreed to absorb with respect to its counterparty before requiring the counterparty to post collateral to cover that exposure.

[33] Final IOSCO Report, *supra* note 6, at 8.

[34] Margin and Capital Requirements for Covered Swap Entities, 79 Fed. Reg. at 57,370.

[35] *Id.* at 57,355.

[36] American Council of Life Insurers public comment letter, *available at* http://www.regulations.gov/#!document Detail;D=OCC-2011-0008-0172; Federal Home Loan Banks public comment letter, *available at* http://www.regulations.gov/ #!documentDetail;D=OCC-2011-0008-0174.

[37] The CSA is the most widely used collateral agreement for over-the-counter swaps. Both the CSA and the Collateral Asset Definitions are available at ISDA's website *at* http://www.isda.org/publications/isdacredit-users.aspx.

[38] Final IOSCO Report, *supra* note 6, at 16-17.

such margin. In this case, or if the other counterparty would like for its swap entity counterparty to post variation margin, the obligation to post variation margin must be negotiated into the relevant trading documentation.

Compliance Dates

The PR Proposed Rule and the CFTC Proposed Rule have the same timeline for compliance. For variation margin, all covered swap entities and non-bank swap dealers must comply with the Margin Rules on December 1, 2015. This compliance date applies to all financial end-users as well since they must post to, and receive variation margin from, these entities from that date regardless of whether they have a material swaps exposure. The Final IOSCO Report also had initially recommended that variation margin requirements be implemented for new contracts on December 1, 2015;[39] however, this was recently revised to September 1, 2016 for entities belonging to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives exceeds €3 trillion, and March 1, 2017 for all other entities so as to give market participants sufficient time to prepare for compliance.[40] While there is a strong likelihood that IOSCO's latest recommendation will result in a similar postponement in the compliance dates currently proposed by US and European regulators, their agreement to any such extension has not yet been announced.

For the initial margin requirement, the Margin Rules provide for a phased-in compliance schedule that is based on the average daily aggregate notional amount of covered swaps between the covered swap entity and its counterparty. Most financial end-users that have material swaps exposure (and are thus subject to the initial margin requirements) would likely not be subject to the initial margin requirements until December 1, 2019 (due to high thresholds for earlier compliance dates); however, compliance dates would arrive earlier for covered swap entities, beginning on December 1, 2015. As noted above, the Final IOSCO Report had also included a recommendation for a phased-in compliance schedule for initial margin beginning on December 1, 2015 for non-cleared trades exceeding €3 trillion and December 1, 2018 for non-cleared trades exceeding €0.75 trillion, but this was recently revised so that the requirement now will come into effect on September 1, 2016 and September 1, 2019, respectively. See attached Appendix A for the compliance schedule for both the Margin Rules and the Final IOSCO Report (as revised).

CONTROVERSIAL ISSUES RELATING TO THE MARGIN RULES

Phase-In Period. Market participants have commented that given the complexity of the Margin Rules, more time is needed to prepare for rule compliance. At a minimum, market participants must have appropriate documentation, systems, and processes for monitoring and maintaining margin transfers and valuation in place before the rules are effective, all of which take time to establish. In addition, phased-in compliance dates should be allowed for variation margin requirements as well as the initial margin requirements. As noted above, the recommendations in the Final IOSCO Report were recently revised to include a phased-in compliance timetable for variation margin. Although there has not been a formal announcement to date, there is a strong likelihood that the US and European regulators will follow suit.

Addressing Market Risk. The primary purpose behind the Margin Rules is to reduce systemic risk in the market by requiring certain market participants to ensure there is "cover," in the form of posted initial and variation margin, for their derivatives exposures. However, such a requirement could have effects that increase risk in other ways; for example, the variation margin alone that is posted by market participants pursuant to the rules may be as high as $1 trillion in the aggregate, with billions more of additional liquidity needed for swap dealers and financial entities.[41] Initial margin payments could be as high as $2 trillion in the aggregate, a substantial amount of which may be segregated in custodial accounts.

The margin posted back and forth, while protected to some extent, is itself at risk. In the event of an insolvency of a party's counterparty, or perhaps the custodian itself, the posted margin may never be returned in its entirety (or at all). This is particularly problematic for initial margin: it cannot be netted against amounts due to the other party in the event of a default by such party to the same extent as variation margin. Market participants also have expressed

[39] Final IOSCO Report, *supra* note 6, at 23.

[40] *See* https://www.bis.org/bcbs/publ/d317.htm.

[41] *See* Letter to Mr. David A. Stawick, Commodity Futures Trading Commission from ISDA, and Securities Industry and Financial Markets Association dated Sept. 14, 2012, *available at* http://www.federalreserve.gov/SECRS/2012/October/20121015/R-1415/R-1415_092412_108399_420582239127_1.pdf (RIN 3038-AC97 – Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants).

concern that the margin requirements would impact their businesses in a way that requires an adjustment of their hedging strategies and could possibly curtail job creation, research and development, acquisitions, and business investments.[42]

Limitation of Eligible Collateral. Both the Prudential Regulators and the CFTC have been clear that variation margin should be limited to cash; however, many end-users, to the extent that they exchange variation margin with their OTC swaps counterparties, routinely post other assets that are high-quality, liquid, and readily marketable, such as U.S. Treasury and agency securities. Requiring cash will affect liquidity and would be costly for those entities that have traditionally posted collateral other than cash. The limitation of eligible collateral would also require many end-users to rely on other arrangements that would expose them to further credit risk in the market, *e.g.*, committed repurchase lines.[43] Many of the public comment letters submitted in response to the Margin Rules cited the limitation on cash for variation margin as imposing unnecessary financial burdens, particularly on end-users such as insurance companies and pension funds. These financial burdens could result in market volatility and increased costs that are passed on to the public. Commenters also emphasized that the Final IOSCO Report allows for non-cash margin for variation margin, which would create a disconnect between the U.S. and global standards for margin.[44]

Retroactive Effect. Perhaps one of the most dramatic impacts of the Margin Rules relates to the ability of parties to net their previously existing positions that are not subject to the rules, with transactions that, following the effective date and any phase in periods, will be subject to the rules. Notwithstanding the Margin Rules' grandfathering of legacy trades, the rules would have a retroactive effect on existing swaps for *all* swaps entered into under a single master agreement, *i.e.*, an agreement that includes both swaps entered into prior to the compliance date of the new margin requirements and swaps entered into after the compliance date. In that case, the rules would require that both initial and variation margin are calculated and posted on an aggregate net basis. If a party does not wish to net legacy swaps on an aggregate basis, it would have to enter into new master agreements that would cover only those swaps entered into with a covered swap entity or swap dealer after the final margin rules' compliance dates. Potentially, because of staggered compliance dates under the rules, three master agreements could be required to avoid retroactive treatment with respect to both variation and initial margin requirements as follows: one master agreement would apply to swaps entered into before the variation margin requirements become effective on December 1, 2015 (based on the current proposed timeline); a second master agreement would cover swaps entered into from December 1, 2015 until the initial margin requirements become effective; and a third master agreement would govern swaps entered into after the initial margin requirements become effective. If a market participant structured its agreements accordingly, it would guarantee that no swaps would be subject to new margin requirements on a retroactive basis. However, the unwanted side effects — namely, the inability to net trades documented under separate master agreements and the administrative burden of having three separate master agreements in place just for this purpose — may make the benefits of avoiding this retroactive effect less worthwhile.[45]

Implications of Including Affiliates in Key Calculations. The Margin Rules require covered swap

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[42] Coalition for Derivatives End-Users: The Impact of Margin Requirements on Main Street Businesses, *available at* http://www.coalitionforderivativesendusers.com/uploads/sites/351/EndUserMarginSurvey3%202014%202.pdf?utm_source=FIA+Weekly+Briefing+-+03%2F28%2F14+&utm_campaign=FIA+WeeklyBriefing_0328&utm_medium=email.

[43] ISDA conducted a survey of 400 end-user market participants regarding the new margin rules. 65% of the respondents were concerned that they could comply with the new requirements as currently proposed. ISDA Insight Survey: End-Users Uncertain about New Margin Requirements, Jan. 6, 2015, *available at* http://www2.isda.org/functional-areas/research/surveys/end-user-surveys/.

[44] *See, e.g.*, Comment 60053 by Warren Davis on behalf of the Federal Home Loan Banks, *at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60053&SearchText=federal%20home *at* 8; Comment 60046 to Proposed Rule 79 FR 59898 by Brandon Becker on behalf of TIAA-CREF, *at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60046&SearchText= ; Comment 60013 to Proposed Rule 79 FR 59898 by Kenneth Bentsen on behalf of the Securities Industry and Financial Markets Association *at*

footnote continued from previous column...

http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60013&SearchText= , at 22; Comment 60057 by Michael Bopp on behalf of the Coalition for Derivatives End-users *at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60057&SearchText=, at 10.

[45] One potential solution to the netting conundrum posed by the Margin Rules could be to have master netting agreements in place, or include provisions within each agreement that allow set-off among the agreements.

entities and financial end-users to determine the $65 million initial margin threshold, and financial end-users to calculate whether they have material swaps exposure, on a consolidated entity basis. This may prove difficult for certain market participants, including asset managers. It may not be possible or practical for market participants to obtain information from, and allocate initial margin thresholds between, affiliated entities given the expansive proposed definition of "affiliate."[46]

Calculating Material Swaps Exposure. The Margin Rules do not address the scenario where a financial end-user ceases to have material swaps exposure. The rules indicate that material swaps exposure is to be calculated by reference to the months of June, July, and August of the prior calendar year. The Margin Rules are not clear as to what happens when a financial end-user meets the material swaps exposure test in year one, but not in a subsequent year. Must all initial margin posted during the period when the entity had material swaps exposure be immediately returned or does it only mean that it will not be required to post initial margin for future trades? To the extent that the posting of initial margin was anticipated and impacted the pricing of prior trades, the return of posted initial margin could impact the expected economics of the transaction. Because posting initial margin will be burdensome, we anticipate that financial end-users that fall below the material swaps exposure threshold prior to the stipulated calculation timeframes would want to cease having to post initial margin as soon as possible after they fall below the material swaps exposure threshold.

Calculations of Margin and Dispute Resolution. The Margin Rules allow covered swap entities to calculate how much initial margin to require from each counterparty by either using a risk-based model or the method set forth in the (identical) standardized table in each of the PR Proposed Rule and the CFTC Proposed Rule. The risk-based model must be subject to periodic review and oversight, and also be approved in advance by the entity's regulator (and again if the model should change). While the regulatory approval process provides some comfort to counterparties subject to these individualized risk-based models that the calculations are done in a commercially reasonable manner, the disparity among the models from one covered swap entity to another and lack of transparency as to how the amounts are calculated, are troubling features of the Margin Rules.[47] It is unclear, for example, how a counterparty asked to post initial margin could dispute whether the requested amount is reasonable in relation to the transaction. The ability to resolve disputes is also relevant to the calculation of variation margin, perhaps to a lesser extent since variation margin is highly related to the value of the swap transaction itself, which can be reasonably quantified by both parties. In addition, there are existing dispute resolution procedures in the CSA that would apply.[48] Nonetheless, public commenters have requested that the final rules require that documentation relating to the new margin rules include specific dispute resolution language for both initial margin and variation margin requirements, *e.g.*, for variation margin, by requiring the parties to seek prices based on recently executed transactions, valuations provided by independent third parties, or other objective criteria.[49]

Characterization of Treasury Affiliates and Centralized Hedging Centers. Certain market participants consolidate their swaps trading activities in treasury affiliates or centralized hedging centers. Under the CEA, such affiliates and centralized hedging centers are considered "financial entities" because they are predominantly engaged in activities that are financial in nature. The Margin Rules do not include treasury affiliates and centralized hedging centers in the "financial end-user" definition, but such entities are not expressly excluded either. Given that the CFTC has acknowledged in other contexts that treasury affiliates undertake hedging activities on behalf of non-financial affiliates and, thus, should be treated differently from

[46] *See supra* n. 24.

[47] *See, e.g.,* Comment 60013 to Proposed Rule 79 FR 59898 by Kenneth Bentsen on behalf of the Securities Industry and Financial Markets Association *at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60013&SearchText= at 6. Many market participants and trade groups have argued for one standardized industry model, and ISDA is currently working to create parameters for such a standardized model.

[48] *See, e.g.,* the ISDA 1994 form of Credit Support Annex subject to New York law, ¶5(ii) and 13(f)(ii).

[49] *See, e.g.,* Comment 60053 by Warren Davis on behalf of the Federal Home Loan Banks, *at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60053&SearchText=federal%20home at 6-7. In addition, potential disputes may arise concerning the value of non-cash collateral posted to a counterparty and whether a specific non-cash collateral qualifies as eligible collateral. These issues should also be addressed in the contractual documentation.

other "financial entities,"[50] such entities should be given certainty that they will not be captured by the Margin Rules, *e.g.*, the requirement for financial end-users to exchange variation margin beginning on December 1, 2015 (based on the current proposed timeline).

Changes to Trading Documentation. While there is some uncertainty as to the content of the final Margin Rules, most market participants likely will be facing additional documentation requirements. The negotiation of OTC derivatives trading documentation can often take months to complete; thus, market participants should be aware of the relevant compliance dates under the Margin Rules (and the specific documentation changes that will be required) to avoid a disruption in trading. At a minimum, these changes would include provisions for separate calculations and payments for initial and variation margin, modifications to collateral thresholds, eligible collateral, minimum transfer amounts, dispute resolution, and mandatory collateral transfer days.[51] ISDA is expected to publish a new version of the CSA that will comport with the Margin Rules for initial and variation collateral when the rules are finalized.[52]

Segregation of initial margin is required by the Margin Rules, but may also arise independently of the Margin Rules. Further, the Dodd-Frank Act provides the right of all end-users to insist upon the segregation of initial margin posted to swap dealers.[53] ISDA has already taken steps to facilitate documentation of tri-party arrangements with independent custodians by publishing a standard form of account control agreement ("ISDA ACA").[54] The ISDA ACA may be of particular interest to non-financial entities (or financial entities that do not have material swaps exposure) that agree to post initial margin to swap dealers and wish to have such margin segregated. End-users should anticipate that extensive negotiation will be required before an agreement based on the ISDA ACA is ready for execution.

ISDA has also developed a standard form of independent amount segregation notice that would allow both swap dealers and their counterparties to comply with the relevant rules.[55] Swap dealers are required to notify their counterparties of this segregation right[56] and upon receiving such notice, counterparties must provide a response to the question of whether or not to segregate initial margin.[57] The notice of the right to segregate collateral provided by the swap dealer is required to include certain information, such as the names of one or more custodians as acceptable depositories for

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[50] *See, e.g.,* CFTC No-Action Letter No. 14-144 dated November 26, 2014 regarding the Clearing Requirement for Swaps Entered into by Eligible Treasury Affiliates, *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-144.pdf.

[51] For example, under the current form of CSA, Independent Amounts are integrated into the calculation of variation margin; under the Margin Rules, initial margin is calculated separately from variation margin and the two amounts cannot be netted into a single payment.

[52] ISDA previously published a base form of amendment agreement to the CSA (the "Amendment Agreement") that addresses the adjustments that must be made when one of the parties to an ISDA Master Agreement agrees to post and segregate independent amounts, which are akin to initial margin. This could be the starting point for a new CSA to address the Margin Rules. Note that the Amendment Agreement does *not* address a scenario where both parties to the ISDA Master Agreement are posting independent amounts to each other (*i.e.*, the Amendment Agreement is drafted with the assumption that the initial margin will be only applicable to "Party B" under the agreement). If both parties are posting initial margin, the parties must make necessary adjustments to the Amendment Agreement or enter into two such agreements.

[53] CEA § 4s(l).f.

[54] The ISDA ACA can be accessed *at* http://www2.isda.org/functional-areas/infrastructure-management/collateral/. Like most tri-party account control agreements, the ISDA ACA establishes the relationship between the party posting the initial margin (*i.e.*, the pledgor), the party receiving the initial margin (*i.e.*, the secured party), and the securities intermediary (*i.e.*, the custodian), and is structured in the traditional ISDA format, with a base form agreement and several optional annexes the parties can use to customize the agreement. Parties should carefully review these and any separately proposed modifications to ensure that they are selecting the appropriate options for their tri-party custodial arrangement.

[55] ISDA's Form of CFTC IM Segregation Right Notice, *available at* http://www2.isda.org/functional-areas/infrastructure-management/collateral/.

[56] Swap dealers have been required to offer segregation of initial margin to any new counterparties as of May 5, 2014. Market participants trading with a swap dealer prior to January 6, 2014 (when the CFTC's rule regarding segregation of initial margin became effective) must have been offered the right to segregate initial margin by November 3, 2014.

[57] Market participants have the ability to designate an appropriate contact person for purposes of this notice, as well as elect whether or not initial margin must be segregated or not, through the ISDA Amend portal, which can be accessed here: http://www.markit.com/product/isda-amend. This service is free to end-user market participants.

segregated initial margin,[58] and pricing information, to the extent the dealer has such information available to it. Counterparties should be aware that swap dealers are not required to disclose which of the custodians listed on the notice is a creditworthy *unaffiliated* entity (though, it may be obvious from the name), nor are they required to provide the source of the pricing information provided.

CONCLUSION

Although the Margin Rules have yet to be finalized, it is certain that all market participants in the OTC derivatives markets, whether regulated banks, swap dealers, financial entities, or traditional "end-users" will be affected, directly or indirectly, by the new requirements. Weathering the regulatory storm will benefit these participants to the extent the new margin requirements reduce counterparty credit risk. However, in exchange, many market participants will be faced with liquidity concerns, increases in transaction pricing, potential inability to net exposures, and the need to overhaul existing (and possibly enter into new) trading documentation. These issues likely will be exacerbated as the interplay of the Margin Rules with the capital rules applicable to banks and swap dealers become more clear over time. For the time being, market participants are urged to understand which of the Margin Rules will apply to them directly, take into account those that will affect them indirectly, and begin an assessment of their readiness to post and collect margin as required, and of the changes to trading and collateral documentation that will be necessary when the Margin Rules become final.■

[58] At least one of these custodians must be a creditworthy unaffiliated entity, though the swap dealer is not required to indicate which entity on the list fits those parameters.

APPENDIX A

Phase-In Schedule

PR Proposed Rule And CFTC Proposed Rule:

Compliance Date	**Initial Margin Requirements** Where both the covered swap entity combined with its affiliates, and the counterparty combined with its affiliates, have an average daily aggregate notional amount of covered swaps for June, July, and August of:
12/1/15	2015 that exceeds $4 trillion
12/1/16	2016 that exceeds $3 trillion
12/1/17	2017 that exceeds $2 trillion
12/1/18	2018 that exceeds $1 trillion.

On 12/1/19, the initial margin requirements apply to any other covered swap entity with respect to covered swaps with any other counterparty.

No phase-in proposed for variation margin requirements.

IOSCO Report:

Compliance Date	**Initial Margin Requirements** Any covered entity belonging to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives for March, April, and May trading with another covered entity also meeting the same conditions in year:
9/1/16 to 8/31/17	2016 exceeds €3.0 trillion
9/1/17 to 8/31/18	2017 exceeds €2.25 trillion
9/1/18 to 8/31/19	2018 exceeds €1.5 trillion
9/1/19 to 8/31/20	2019 exceeds €0.75 trillion
9/1/20	2020 and beyond exceeds €8 billion.

Compliance Date	**Variation Margin Requirements**
9/1/16	Covered entities belonging to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives exceeds €3 trillion.
3/1/17	All other covered entities.

Chapter 66

UNITED STATES

Richard Hall and Mark Greene[1]

I OVERVIEW OF M&A ACTIVITY

Calendar year 2014 saw a substantial increase in merger and acquisition (M&A) activity globally and in the United States. Total 2014 US M&A activity[2] by dollar volume increased by 50.2 per cent over 2013 levels, benefiting from global and national economic recovery, high stock prices and low interest rates.[3] The value of US domestic deals[4] increased 158.5 per cent over 2013 levels, making 2014 the most active year for domestic deals since 2007.[5] US outbound M&A reached the highest value and deal count on record and was up 65.9 per cent from 2013 levels, with tax inversions strongly contributing to this increase.[6] Announced US targeted M&A[7] reached $2.1 trillion in

1 Richard Hall and Mark Greene are corporate partners at Cravath, Swaine & Moore LLP. The authors would like to acknowledge the contributions of fellow partners Eric Hilfers, Len Teti and Christine Varney and associates Rebecca Hurt, Jesse Weiss, Karice Rhule and Kristin Rulison.

2 US M&A activity includes announced deals where the target or acquirer is domiciled in the US.

3 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, Thomson Reuters (2014), http://online.thomsonone.com.

4 Domestic deals are those where the US is the dominant geography of the target and bidder.

5 'Global and Regional M&A: 2014', Mergermarket, January 2015, www.mergermarket.com/pdf/Mergermarket%202014%20M&A%20Trend%20Report.%20Financial%20Advisor%20League%20Tables.pdf.

6 Id.

7 US targeted M&A includes announced deals where the target is a US entity (whether a standalone entity or division).

dollar volume, up 51.4 per cent from 2013.[8] This rise in US M&A activity follows the worldwide current: global M&A activity had its strongest annual period since the financial crisis, with overall value up 47 per cent from 2013 levels, fuelled by over 40,400 deals announced worldwide.[9]

The upswing in US M&A activity resulted from a spike in mega-deals rather than in absolute deal volume and predominantly occurred in the public M&A sector. The 50.2 per cent increase in US M&A by dollar volume was accompanied by a deal count increase of only 10 per cent over 2013 levels.[10] Within US public M&A, the number of deals over $100 million only increased 7.9 per cent from 2013, but the average value of those announced deals more than tripled, going from $1.3 billion to over $4.5 billion, and the average value of the 10 largest US public mergers rose from $6.4 billion to $44.4 billion.[11] The number of acquisitions of US public companies valued at $5 billion or above more than doubled from 2013, and these deals represented close to a quarter of overall US M&A activity, up from 10 per cent the previous year.[12] These large cap public deals were at the core of US M&A in 2014, representing some of the largest financings and the most notable hostile deals and being at the centre of some of the regulatory issues which arose in 2014.

This rise in US public M&A was dominated by strategic, rather than financial, acquirers, as financial acquirer transactions dropped from around 25 per cent in 2013 to 12.6 per cent.[13] One factor that contributed to the rise of strategic acquirers was the rise in stock prices as acquirers used their own highly valued stock to buy competitors. In 2014, nearly 50 per cent of public deals included stock as part or all of the consideration, as opposed to only 30 per cent the previous year.[14] Of the top 15 worldwide mega-deals, the eight that had both a US acquirer and a US target involved stock as part of the consideration.[15] Leveraged public US M&A only slightly rose in 2014, going from 40.7 per cent in 2013 to 47 per cent.[16]

The mega-deals that caused the US M&A surge are a worldwide phenomenon but particularly prevalent in the US. Of 95 worldwide deals over $5 billion, the top five were each over $50 billion and involved a US acquirer and a US target, and, of the top

8 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, *supra* note 3; Mergers & Acquisitions Review, Full Year 2013, Financial Advisors, Thomson Reuters (2014), http://online.thomsonone.com.

9 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, *supra* note 3.

10 Id.

11 Practical Law Company, 'What's Market: 2014 Public M&A Wrap-up', 28 January 2015, http://us.practicallaw.com/3-597-1086?q=What's+Market:+2014+Year-end+Public+M%26A+Wrap-up; '2014 Year-End Roundup', Paul, Weiss, Rifkind, Wharton & Garrison, 15 January 2015, www.paulweiss.com/media/2765032/ma_2014_year-end_roundup.pdf.

12 Id.

13 Id.

14 Id.

15 Id.

16 Id.

15 (ranging from $17.1 to $70.7 billion in deal value), eight involved both a US acquirer and a US target and two more involved at least one US party.[17] Within US mega-deals, five of the top-10 US deals were in the media and entertainment, and pharmaceutical and health-care sectors, which is consistent with the worldwide M&A trend in which media and entertainment M&A activity doubled and health-care M&A activity rose 94 per cent from the previous year.[18]

The continued viability of some of these mega-deals is being called into question by regulatory concerns. Topping the list of US targeted M&A in 2014 were two media and entertainment or cable mega-deals, which have since been stalled or entirely blocked by regulatory review. The first was the announced acquisition of Time Warner Cable Inc by Comcast Corp, with a deal value of $70.7 billion, which was abandoned in late April 2015 under pressure from antitrust regulators.[19] The second was the announced acquisition of DirectTV Inc by AT&T Inc with a deal value of $67.2 billion, which is under Federal Communications Commission (FCC) review. The deal was stalled in March 2015 as the FCC paused its 180-day review of the proposed merger, waiting for the DC Circuit Court of Appeals to rule on contract information disclosure to third parties.[20] The court ruled for the broadcasters and FCC review picked up again in May 2015, with the outcome still undecided.[21] That said, US-targeted M&A continued to strengthen in the first quarter of 2015, totalling $415.9 billion, up 33 per cent by dollar volume from the first quarter of 2014 and reaching the highest first quarter level since 2000, with US mega-deals still strongly represented (including the HJ Heinz Co acquisition of Kraft Foods Group Inc for $54.7 billion).[22]

Along with mega-deals, inversions and shareholder activism played important roles in structuring US public M&A in 2014, though the rising use of inversions slowed in late 2014 due to government regulation.[23]

17 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, *supra* note 3.

18 Id.

19 Id.; Shalini Ramachandran, 'Comcast Kills Time Warner Cable Deal', *Wall Street Journal*, 24 April 2015, www.wsj.com/articles/comcast-kills-time-warner-cable-deal-1429878881.

20 Mergers & Acquisitions Review, Full Year 2014, Financial Advisors, *supra* note 3; Thomas Gryta and Shalini Ramachandran, 'FCC Puts Review of Comcast-Time Warner, AT&T-Direct TV Deals on Hold', *Wall Street Journal*, 13 April 2015, www.wsj.com/articles/fcc-puts-review-of-comcast-time-warner-at-t-directv-deals-on-hold-1426276188.

21 Meg James, 'Court Backs Broadcasters, Clears Way for FCC Review of AT&T-DirectTV Merger', *LA Times*, 8 May 2015, www.latimes.com/entertainment/envelope/cotown/la-et-ct-broadcasters-fcc-dispute-att-directv-merger-review-20150508-story.html.

22 Mergers & Acquisitions Review, First Quarter 2015, Financial Advisors, Thomson Reuters (2015), http://online.thomsonone.com.

23 'What's Market: 2014 Public M&A Wrap-up', *supra* note 11.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

M&A in the US is governed by a dual regulatory regime, consisting of state corporation laws (e.g., the Delaware General Corporation Law (DGCL)) and the federal securities laws (primarily, the Securities Act of 1933 and the Securities Exchange Act of 1934). The Securities and Exchange Commission is the regulatory agency responsible for administering the federal securities laws. The federal securities laws apply in the context of a merger, including proxy rules that govern the solicitation of the approval of a target company's shareholders. The federal securities laws relating to tender offers apply in the context of an offer to purchase shares of a publicly held target company. In addition to these laws, an acquisition or merger will imply fiduciary duties, as developed and applied in the state of incorporation of the target company.

Unlike most other jurisdictions, the US patchwork of federal and state regulation of acquisitions is not focused on the substantive issue of regulating changes of control of target companies. Rather, US federal regulation focuses on disclosure, ensuring that common shareholders of target corporations are given the time and information required to make a fully informed decision regarding the acceptance of a tender offer or vote in favour of a merger.

Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the HSR Act), an acquirer is normally required to make a filing with US antitrust authorities prior to completing the acquisition. Generally, the HSR Act requires notification if the size of the transaction exceeds $76.3 million (adjusted annually for inflation); the requirement was increased from $75.9 million in 2014.[24]

There is no general statutory review process governing foreign investment in the United States. Under the Exon-Florio Amendment to the Defence Production Act of 1950 (Exon-Florio Amendment), however, the President, through the Committee on Foreign Investment in the US (CFIUS), has the power to review, investigate, prohibit or unwind transactions involving investments by non-US entities that threaten to impair national security.[25] The 1992 Byrd Amendment also requires CFIUS to conduct a full Exon-Florio investigation whenever CFIUS receives notice of a foreign government-led takeover of a US business that may affect national security.[26]

There are also additional industry-specific statutes that may require advance notification of an acquisition to a governmental authority. Examples of regulated industries include airlines, broadcasters and electric and gas utilities.

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24 'FTC Announces New Thresholds for Clayton Act Antitrust Reviews for 2015', Fed. Trade Comm'n, www.ftc.gov/news-events/press-releases/2015/01/ftc-announces-new-thresholds-clayton-act-antitrust-reviews-2015.

25 50 U.S.C. app, Section 2170.

26 Pub. L. No. 102-484 (1992).

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Standard of review for certain controlling shareholder transactions

In *In re MFW Shareholders Litigation*, the Delaware Court of Chancery issued a seminal opinion establishing that the deferential business judgement rule is the appropriate standard of review in the case of a merger between a controlling shareholder and its subsidiary where from the outset the controlling shareholder agrees the transaction will be conditioned on the approval of both an independent and empowered (to negotiate and not simply evaluate) special committee that fulfils its duty of care and the uncoerced and informed vote of a majority of the minority of shareholders unaffiliated with the controlling shareholder.[27]

Prior to *In re MFW*, where a controlling shareholder stood on both sides of a transaction, the actions of the target's board of directors were reviewed under the exacting entire fairness standard as the transaction was necessarily a conflicted one. Under entire fairness, the Delaware courts evaluate the entirety of the transaction focusing on two interrelated prongs: whether a fair process was used and whether a fair price was paid.[28] The best defendants could hope for was shifting the burden to plaintiffs by conditioning the transaction on either a special committee of independent directors or the approval of the majority of the minority of shareholders unaffiliated with the controlling shareholder.[29] The Delaware courts had never had occasion to opine on the appropriate standard of review if both protections were in place.

In *In re MFW*, the defendants argued that the use of both protections created an arm's-length dynamic that called for review under the business judgement rule, under which a Delaware court will not second-guess a board of directors' decision if it can be attributed to any rational purpose.[30] The Court of Chancery largely agreed with this reasoning and noted that, because controlling shareholders did not receive 'extra legal credit' for putting in place both legal protections (i.e., burden shifting remained the best possible outcome), there had been no incentive for them to do so.[31] Acknowledging that its decision could be overturned by the legislature or the Delaware Supreme Court, the Court of Chancery, after reviewing the independence of the special committee and whether or not it had been sufficiently empowered and had fulfilled its duty of care, adopted the business judgement rule as the appropriate standard of review.[32]

In March 2014, the Delaware Supreme Court upheld the Court of Chancery's decision, but modified the Court of Chancery's duty of care test.[33] The Supreme Court

27 *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013).

28 *In re S. Peru Copper Corp. S'holder Derivative Litig.*, 52 A.3d 761, 787, 2011 Del. Ch. LEXIS 212, 75 (Del. Ch. 2011) (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

29 *In re MFW S'holders Litig.*, 67 A.3d at 500 (quoting *Kahn v. Lynch Commun. Sys.*, 638 A.2d 1110, 1117 (Del. 1994)).

30 *In re MFW S'holders Litig.*, 67 A.3d at 500.

31 Id. at 500-01.

32 *In re MFW S'holders Litig.*, 67 A.3d at 501-04.

33 *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

held that in particular the duty of care has to be met with respect to negotiating price.[34] In a footnote, the Supreme Court noted various claims in the class complaint regarding price (e.g., the final merger price was $2.00 lower than the company's trading price two months earlier) that could have called into question the sufficiency of the special committee's negotiations, requiring discovery to determine whether the test had been satisfied.[35] The Supreme Court's discussion regarding whether the special committee adequately conducted negotiations, in effect, blurred the lines between application of the business judgement rule and entire fairness. The type of allegations that the Supreme Court pointed to are common in complaints regarding controlling shareholder transactions. The Supreme Court's focus on due care with respect to price could limit the benefits of the standard as established by the Court of Chancery necessitating extensive discovery and leaving a target board of directors in the context of a takeover by controlling shareholder, unsure as to whether the business judgement rule will ever apply to its actions.

In August 2014, the Delaware Court of Chancery attempted to remove some of this uncertainty by shifting the burden of proof to the plaintiffs, requiring them to plead sufficient facts to demonstrate that the elements of the duty of care test had not been meet and that application of the business judgment rule was therefore unwarranted.[36] While the court's stance fails to guarantee to a target board of directors that the business judgment rule will be applied to its action, it could allow defendants to dismiss cases at the pleading stage, by limiting plaintiffs' ability to get to discovery by relying on mere allegations of the board of director's failure. The decision also clarified that the negotiating price would only be reviewed under a gross negligence test (the standard a board of directors is held to) at the pleading stage, doing away with concerns of an entire fairness review before trial. The decision is a bench ruling, and therefore not technically precedential, but it is the first decision following the March 2014 decision and potentially reveals a permanent clarification in the test's application.

ii Facilitation of the two-step merger

In August 2013, Section 251(h) of the DGCL was added to Section 251, eliminating the requirement for a shareholder vote in certain two-step mergers. In August of 2014, Section 251(h) was amended to allow application of the provision even when an 'interested stockholder' is involved and to remove Section 251(h)'s mandatory application, now allowing, rather than requiring, parties to a merger agreement to rely on it and expanding their world of regulatory options to consummate the transaction.

A two-step merger is a hybrid acquisition structure for a target company that combines a tender or exchange offer (offer) with a 'back-end' merger, in which shareholder approval is a fait accompli, or a short-form merger, in which shareholder approval is not required by law. This is in contrast to a one-step long-form merger in which the shareholders of the target company generally have a meaningful vote on the

34 M&F Worldwide Corp., 88 A.3d at 644-45.

35 M&F Worldwide Corp., 88 A.3d at 645, n.14.

36 *Swomley v. Schlecht*, No. 9355-VCL (Del. Ch. Aug. 27, 2014) (Transcript).

transaction. The advantage of the two-step merger, in particular where the consideration is cash and regulatory review is not required, is speed. An all-cash two-step merger can be accomplished in a matter of weeks whereas a one-step merger can take several months.

In the case of a two-step merger, the first-step offer is generally conditioned on the tender of the minimum number of shares required to give the acquirer sufficient voting power to approve the second-step merger. If the acquirer holds at least 90 per cent of the target company's common stock after the offer, the acquirer is able to quickly (e.g., the same day) effect a short-form merger under Section 253 of the DGCL, for which a shareholder vote is not required. Often a two-step merger agreement will include a 'top-up' option, which provides that the target company will issue the remaining shares of common stock necessary to put the acquirer at the 90 per cent mark. However, prior to Section 251(h), if for whatever reason the top-up option was not available (e.g., the target company did not have sufficient authorised and unissued shares), the acquirer had to go through the process of obtaining a shareholder vote, even if the vote was a mere formality because the acquirer had obtained the requisite voting control through the offer. Having to obtain the shareholder vote could prove costly to the acquirer, both in terms of the expense of preparing the proxy materials and with respect to the cost of, and access to, debt financing. In addition to any financing needed to acquire the target company's shares, the closing of the offer would also likely require refinancing of the target company's debt. For a corporation with a robust balance sheet, this may not have proved to be a problem, but it placed financial acquirers at a disadvantage. Prior to the consummation of the back-end merger, the acquirer would not have access to the target company's assets for purposes of collateral and the acquirer's ability to borrow funds using the shares as security is limited by US margin rules (no more than 50 per cent of the purchase price of the shares can be borrowed).

When enacted, Section 251(h) bridged the gap between the long-form merger approval threshold and the 90 per cent short-form merger threshold. Subject to certain conditions, it provided that in the case of a two-step merger, if following the consummation of the offer, the acquirer holds the requisite number of shares to approve the back-end merger, shareholder approval is not required. In addition to getting deal proceeds into the hands of shareholders as quickly as possible, the provision provided the added benefit of levelling the playing field for acquirers obtaining third-party financing, potentially increasing the potential number of competitive bids.

In August 2014, Section 251(h) was amended to remove the 'interested stockholder' restriction; it allows the provision to be used even if a party to the merger agreement at the time the agreement receives board approval is an 'interested stockholder' as defined in Section 203 of the DGCL (generally a holder of 15 per cent more of the target company's outstanding shares), which was previously prohibited. This expansion permits acquirers to enter into tender and support agreements with shareholders or groups of shareholders that own 15 per cent of the target company's stock, permitting management buyouts and also allowing acquirers to rely on both Section 251(h) and the assurance of locking up a significant portion of a target company's shares, opening the door for Section 251(h) to be used in the context of 'going private' transactions. In the 12-month period following the adoption of Section 251(h), two-step mergers were used in 34 per cent of all M&A transactions with a Delaware corporate target, as opposed to only 23 per cent in the year leading up to it.[37] Of the two-step mergers that did not rely on Section 251(h) during that time period, 49 per cent involved tender or support agreement, which suggest we can expect a further surge in two-step mergers now that the 'interested stockholder' restriction has been lifted.[38] That said, the removal of the restriction in Section 251(h) has not removed the restrictions on 'interested stockholder' transactions in Section 203 and the exact amount of the increase is still to be determined.[39]

The amendment makes further changes to Section 251(h). It makes the provision 'opt-in' rather than exclusive, permitting parties to a merger agreement to rely on the provision if they explicitly elect it, but allowing them to abandon it in favour of consuming the transaction under another statutory provision they find more beneficial. This gives parties to a merger agreement greater comfort as they enter into the merger process; they can rely on the section but can save the merger with another provision if Section 251(h) is revealed unusable. The amendment also clarifies that an offer for 'any and all of the outstanding stock' of a target may exclude stock owned by the target, the acquirer and some of their affiliates, making the 90 per cent ownership threshold easier to attain, but it also now requires that the shares (of the acquirer, the target or a tendering stockholder) be actually received by the depositary to be counted towards the ownership threshold.

iii Forum by-laws

From 2010 until 2013, 90 per cent or more of US M&A deals over $100 million resulted in shareholder litigation, with 62 per cent of deal litigation being multi-jurisdictional and deals facing an average of five lawsuits.[40] Plaintiffs engaging in forum shopping (the practice of filing claims in the jurisdiction(s) most likely to be favourable to their claim) tend to file claims in multiple jurisdictions. Other plaintiffs simply file in their own jurisdiction for convenience, failing to group their claims with those of other shareholders, resulting in corporations having to litigate similar claims in multiple jurisdictions, with all associated burdens: inconsistent results across claims, increased costs due to multiple counsels, filings and proceedings, and litigating claims in courts with less expertise on certain corporate matters pertinent to the corporations concerned.[41] In response, corporations began enacting unilateral by-law amendments to implement forum by-laws – provisions in their charters or by-laws that provide for an exclusive forum (generally their state of incorporation) in which their shareholders could bring suit against them. In

37 'Section 251(h) Year in Review', Morris Nichols Arsht & Tunnell, www.mnat.com/assets/htmldocuments/Section215h_MorrisNicholsReport_Sept2014.pdf.

38 Id.

39 Id.

40 'Shareholder Litigation Involving Mergers and Acquisitions—Review of 2013 Litigation', Cornerstone Research, February 2014, www.cornerstone.com/GetAttachment/73882c85-ea7b-4b3c-a75f-40830eab34b6/-Shareholder-Litigation-Involving-M-and-A-2013-Filings.pdf.

41 'Exclusive Forum By-laws Gain Momentum', 28 May 2014, Sullivan & Cromwell LLP, www.sullcrom.com/siteFiles/Publications/SC_Publication_Exclusive_Forum_By-laws_Gain_Momentum.pdf.

2013, the Delaware Chancery Court held that forum selection clauses in a corporation's by-laws were facially valid under the DGCL and hundreds of Delaware corporations subsequently announced or adopted forum by-laws.[42]

In 2014, in *City of Providence v. First Citizens BancShares, Inc*, the Delaware Chancery Court reaffirmed its support of forum by-laws and granted more flexibility as to the chosen and the timing of the by-laws' adoption.[43] *First Citizens* upheld a corporation's selection of its principal place of business as its exclusive forum, which in this case was North Carolina.[44] This was notable not only because it was not the corporation's state of incorporation but also because a Delaware court upheld a non-Delaware forum as exclusive in ruling over matters of Delaware corporate law. First Citizens also upheld the board of director's adoption of the forum by-laws on an 'allegedly cloudy day' (simultaneously with a transaction which is now alleged to be a wrongdoing) rather than on a 'clear day' (in the absence of a simultaneous transaction).[45] The court found the distinction 'immaterial given the lack of any well-pled allegations... demonstrating any impropriety in this timing,' making it clear that the timing itself – which was simultaneous with the board action under review (in this case, execution of a merger agreement) – does not in itself render adoption of the forum by-laws improper.[46]

Forum by-laws are not exclusive to Delaware and courts in several states have dismissed shareholder litigation on the basis of forum by-laws.[47] Though one court in California has, post-*First Citizens*, invalidated a forum by-law due to 'the closeness of the timing to the by-law amendment to the board's alleged wrongdoing', another upheld a similar forum by-law despite it being enacted when a merger agreement was signed, suggesting the Delaware trend may spread.[48] Legislation was adopted in Delaware in June 2015, which formally authorises certificates of incorporation or by-laws to include 'forum by-laws'. While the legislation neither expressly authorises nor expressly prohibits selecting a forum other than Delaware, it does invalidate 'forum by-laws' that select another forum to the exclusion of Delaware.[49]

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42 *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013); see Claudia H. Allen, 'Trends in Exclusive Forum By-laws: They're Valid, Now What?', 18 November 2013, Katten Muchin Rosenman LLP.

43 *City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229 (Del. Ch. 2014).

44 Id. at 240.

45 Id. at 241.

46 Id.

47 'Exclusive Forum By-laws Gain Momentum', *supra* note 41.

48 *Roberts v. TriQuint Semiconductor, Inc.*, No. 1402-02441, slip op. at 9-10 (Or. Cir. Ct. Aug. 14, 2014); *Brewerton v. Oplink Communications Inc.*, No. RG14-750111 (Super. Ct. Cal. Dec. 12, 2014).

49 A copy of the proposed amendments is available at: http://legis.delaware.gov/LIS/lis148.nsf/vwLegislation/SB+75/$file/legis.html?open.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

i Inversions

The phenomenon of US corporations reincorporating in low-tax jurisdictions, inversions, is not new. US tax rates are some of the highest globally and US-based companies consistently look for ways to shield their international earnings from those rates. In the past, a company was able to simply reincorporate in a foreign jurisdiction or move to a country in which it was already doing a substantial amount of business and benefit from the country's lower tax rate.[50] For this to work, 25 per cent of the company's sales, assets and employees had to be domiciled in the new jurisdiction.[51] This is a difficult burden for most companies to meet and in the past few years, most inversions were achieved through multibillion-dollar cross-border M&A, 'acquisition inversions'.[52] Under the rules governing acquisition inversions, a foreign target company and acquirer can be combined under a new holding company formed under the laws of a lower-tax foreign jurisdiction, whether or not it is the target company's jurisdiction of organisation, if less than 80 per cent of the combined entity's stock is owned by the former shareholders of the US company.[53] While the past three years have seen a rise in inversions, more notable is the fact that inversions represented 6 per cent of worldwide M&A activity in 2014 due to a wave of high-profile, large-dollar-value inversions, and by September, 2014 had already seen approximately 55 per cent of all inversion dollar value since 1996.[54]

In February 2014, Endo International PLC (formerly Health Solutions Inc) completed its acquisition of Canadian company Paladin Labs Inc for \$1.6 billion and reincorporated in Ireland in March 2014, a move expected to save it millions of dollars in taxes.[55] In March 2014, Horizon Pharma Inc agreed to acquire Vidara Therapeutics Inc for \$600 million, forming a new combined company organised in Ireland that

50 David Gelles, 'New Corporate Tax Shelter: A Merger Abroad', New York Times, 8 October 2013, http://dealbook.nytimes.com/2013/10/08/to-cut-corporate-taxes-a-merger-abroad-and-a-new-home/.

51 David Gelles, 'Obama Budget Seeks to Eliminate Inversions', New York Times, 5 March 2014, http://dealbook.nytimes.com/2014/03/05/obama-budget-seeks-to-eliminate-inversions/.

52 Id.

53 Press Release, Dep't of the Treasury, 'Fact Sheet: Treasury Actions to Rein in Corporate Tax Inversions', 22 September 2014, http://www.treasury.gov/press-center/press-releases/Pages/jl2645.aspx.

54 See Gelles, 'Obama Budget Seeks to Eliminate Inversions', *supra* note 51; Janet Novack and Liyan Chen, 'The Tax Inversion Rush – In One Handy Graphic', Forbes, September 10, 2014, http://www.forbes.com/sites/janetnovack/2014/09/10/the-tax-inversion-rush-in-one-handy-graphic/.

55 John George, 'Endo Re-Incorporates in Ireland to Save Millions in Taxes', Philadelphia Business Journal, 11 March 2014, http://www.bizjournals.com/philadelphia/blog/health-care/2014/03/why-endo-re-incorporated-in-ireland.html.

is expected to lower the combined company's tax rate to the low 20 per cent range.[56] In April and May 2014, Pfizer Inc made offers reaching $119 billion for the United Kingdom-based AstraZeneca PLC, making the tax benefit a clear part of their proposal to AstraZeneca, though eventually getting rejected.[57] In July 2014, Italian drug maker Cosmo Technologies Ltd and Salix Pharmaceuticals Ltd announced a $2.7 billion inversion, and AbbVie Inc and British company Shire PLC announced an inversion valued at $54.8 billion, both of which were ultimately terminated for regulatory reasons described below. That same month, Mylan Inc and Abbott Laboratories announced a $5 billion transaction pursuant to which Mylan would reincorporate in the Netherlands thereby reducing its tax rate to the 20 per cent range and the high teens going forward. In August 2014, after much speculation about whether it would consummate the merger with an inversion, Walgreens Co announced it would (and it eventually did) complete an inversion-free acquisition of the Switzerland-based Alliance Boots GmbH; its decision came shortly after the US Treasury threatened restrictions on tax benefits to US companies relocating abroad for tax reasons.[58] In September 2014, Burger King Worldwide Inc announced its acquisition of Tim Hortons Inc (which it completed in December 2014) and its reincorporation in Canada. The inversion is expected to allow Burger King to avoid hundreds of millions of dollars in US taxes going forward.[59] Burger King's announcement was promptly followed by a governmental announcement of measures to reduce the benefit of corporate inversions.

Governmental measures against corporate inversions are not new, and attempts to rein in such transactions have continued as the US government sees more and more taxable revenue escaping its reach, but the solutions to date have been ineffectual.[60] In September 2014, the US Department of Treasury and the Internal Revenue Service issued a notice of measures intended to render certain inversion-related tax practices more expensive for US companies and raise the bar for inversion eligibility (see Section VIII of this chapter for further discussion on the proposed regulation).

Though the new regulations' long-term impact is still uncertain, after their announcement the wave of inversions slowed for the remainder of 2014 and a few

56 Vrinda Manocha, 'With Eye on Tax Rates, Horizon Pharma Buys Ireland's Ireland', 19 March 2014, www.reuters.com/article/2014/03/19/us-horizonpharma-acquisition-vidara-idUSBREA2I0PE20140319.

57 Harry Stein, 'Pfizer's Tax-Dodging Bid for AstraZeneca Shows Need to Tighten U.S. Tax Rules', 13 May 2014, Center for American Progress, www.americanprogress.org/issues/regulation/news/2014/05/13/89597/pfizers-tax-dodging-bid-for-astrazeneca-shows-need-to-tighten-u-s-tax-rules/.

58 Jennifer Rankin, 'Tax Inversion Takes a Hit as Walgreens Alliance Boots Stays in US', *The Guardian*, 6 August 2014, www.theguardian.com/business/2014/aug/06/walgreens-buy s-alliance-boots-9bn-pounds.

59 Kevin Drawbaugh, 'Burger King to Save Millions in US Taxes in 'Inversion': study', 11 December 2014, www.reuters.com/article/2014/12/11/us-usa-tax-burgerking-idUSKBN0JP0CI20141211.

60 Gelles, 'New Corporate Tax Shelter', *supra* note 50.

high-profile acquisition-inversion deals were terminated. Blaming the new inversion rules and uncertainty regarding future regulation as the drivers, AbbVie Inc terminated its $54 billion bid for Shire PLC in October 2014, incurring a $1.6 billion termination fee.[61] That same month, Salix Pharmaceuticals Ltd and Cosmo Technologies Ltd terminated a $2.7 billion merger agreement with a $25 million termination fee, also citing regulatory concerns. As the Treasury Department continues its efforts to prevent inversions, a possible risk facing companies is a retrospective regulation that would claw back billions of dollars of tax revenue and potentially unwind completed deals, with unpredictable consequences.

ii CFIUS review

Ralls update

In September 2012, President Obama blocked the first merger on CFIUS-related national security grounds in 22 years. Such authority was given to the President under the Exon-Florio Amendment, which was enacted amid concerns over foreign acquisitions, particularly Japanese firms.[62] The transaction at issue was the acquisition by Ralls Corporation (Ralls), a Delaware company owned by executives of China's largest machinery manufacturer, of four wind farm projects near the Naval Weapons Systems Training Facility in Oregon. Ralls had not notified CFIUS prior to the consummation of the transaction. Challenging the President's order, Ralls filed suit claiming that the order, *inter alia*, was an unconstitutional deprivation of property without due process. Having previously dismissed Ralls' other claims, in October 2013, the US District Court for the District of Columbia dismissed Ralls' due process claim.[63] Part of the Court's analysis focused on the fact that Ralls elected not to notify the CFIUS prior to the closing and therefore acquired the property subject to the known risk of the presidential veto. Ralls appealed and, in July 2014, the US Court of Appeals for the District of Columbia ruled that Ralls had not been afforded due process before being deprived of property.[64] The court granted Ralls the right to review and rebut unclassified information that had been used during the CFIUS review process.[65] In November 2014, Ralls was handed unclassified information and factual findings generated during the review, which were the basis for the CFIUS decision, and the district court set a framework in which

61 David Gelles, 'After Tax Inversion Rules Change, AbbVie and Shire Agree to Terminate Their Deal', *New York Times*, 20 October 2014, http://dealbook.nytimes.com/2014/10/20/abbvie-and-shire-agree-to-terminate-their-deal/.

62 Sara Forden, 'Chinese-Owned Company Sues Obama Over Wind Farm Project', Bloomberg, 2 October 2012, (on file with author); James K. Jackson, 'The Exon-Florio National Security Test for Foreign Investment', Congressional Research Service, 29 March 2013, www.fas.org/sgp/crs/natsec/RL33312.pdf.

63 *Ralls Corp. v. Comm. on Foreign Inv. in the United State*s, CV 12-1513 (ABJ), 2013 WL 5565499, *7 (D.D.C. Oct. 9, 2013), as amended (10 October 2013).

64 *Ralls Corp. v. CFIUS*, 758 F.3d 296, 321 (D.C. Cir. 2014).

65 Id. at 319.

Ralls could contest the information.[66] While the outcome for Ralls of this imparted information is currently unknown, the appellate court's decision could impact the overall CFIUS reviews process. CFIUS, now aware that the underlying information and its findings could be disclosed if its decision is contested, has an incentive to exchange information with parties early, grant them a right to rebuttal and address those rebuttals, in order to avoid an appeal with the courts. This may lengthen the review process but the right to rebuttal would be unprecedented and would lend some transparency to a currently secretive process.

2013 CFIUS Annual Report

The 2013 CFIUS annual report to Congress, published in February 2015, reveals an overall expansion of CFIUS review: an increase in the number of cases submitted to the investigation stage and in the duration of CFIUS involvement in transactions under review, the latter part due to a rise in the use of mitigation measures. This expansion may push CFIUS review to become a systematic consideration for parties undertaking M&A transactions.

CFIUS review, which is usually (thought not exclusively) initiated based on the filing of voluntary notices, consists of an initial 30-day period during which the CFIUS reviews the transaction to consider its effects on US national security. If the CFIUS still has national security concerns after the initial period, a second 45-day investigation is launched. In 2013, CFIUS conducted investigations on 49 per cent of notices filed, up from 39 per cent in 2012 and 36 per cent in 2011.[67] While five transactions were submitted to investigation due to incomplete first-stage review caused by the government's shutdown in October 2013, the investigation rate would still be 44 per cent without those five transactions.[68] This inching towards the 50 per cent mark suggests that companies may soon have to assume an investigation stage review of their transaction and provide for it in their negotiations.

Mitigation measures were applied to 11 per cent of reviewed transactions in 2013, up from 8 per cent in previous years.[69] Mitigation measures are an informal practice authorising the CFIUS to enter into agreements with parties to alleviate some of the national security concerns raised by their proposed transactions. Such measures include, among others, making divestments, making modifications to agreements, ensuring only authorised personnel has access to certain technology and information and ensuring only US citizens handle certain products or services. The high-profile proposed acquisition by Chinese insurance company Anbang Insurance Group Co. of the Waldorf Astoria in New York is speculated to have cleared CFIUS review only after mitigation measures

66 *Order, Ralls Corp. v. CFIUS*, No. 12-1513 (ABJ) (D.D.C. Nov. 6, 2014).

67 Comm. On Foreign Inv. in the U.S., Annual Report To Congress (2013), 3 [hereinafter ANNUAL REPORT]; James K. Jackson, 'The Committee on Foreign Investment in the United States (CFIUS)', Congressional Research Service, 6 March 2014, www.fas.org/sgp/crs/natsec/RL33388.pdf.

68 ANNUAL REPORT at 3.

69 Id. at 21.

were included.[70] The Waldorf Astoria is home to foreign presidents visiting New York, the permanent residence of the US ambassador to the United Nations and a favourite location among foreign dignitaries and celebrities and was therefore submitted to the investigation stage of review.[71] If the CFIUS has continued oversight into the management of the Waldorf Astoria for as long as the Chinese company owns the property, the duration of its involvement could span decades. Such prolonged participation, if it rises in frequency, may push parties to an M&A transaction to address the possibility early on in the transaction process. Filing a notice to the CFIUS is a voluntary measure but the CFIUS may review a transaction at its discretion once it is completed. Measures imposed after a deal closes may affect a party's anticipated benefits and would need to be addressed.

CFIUS review is not only becoming more commonplace and more involved, it could become more costly. Failure to obtain regulatory approvals can trigger break-up fees for acquirers and the rise of CFIUS review could push more M&A parties to address it in termination fee provisions. Siemens AG will have to pay Dresser-Rand Group Inc $400 million if its acquisition does not clear review – a measure that could become practice for transactions even remotely related to national industries or concerns.[72]

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

The energy and power sector led the US market for 2014, with deal volume totalling $338.4 billion for 22.1 per cent of market share.[73] Health care followed, with dollar volume of $237.4 billion for 15.5 per cent of market share, nearly tied by media and entertainment, with dollar volume of $207.8 billion for 13.6 per cent of market share.[74]

i Hostile bids

Hostile offers made a comeback in 2014, reaching their highest level for global M&A in 14 years by the month of August.[75] By the same month, US hostile M&A had reached

70 James Rosen, 'U.S. Clears Chinese Purchase of Famed NYC Home to Presidents, Envoys, Celebs', McClatchy Washington Bureau, 3 February 2015, www.mcclatchydc.com/2015/02/03/255388/us-clears-chinese-purchase-of.html; Paul Welitzkin, 'Chinese Insurer Gets Waldorf OK', Washington Post, 3 February 2015, http://chinawatch.washingtonpost.com/2015/02/chinese-insurer-gets-waldorf-ok/.

71 Id.

72 'Implications of National Security Reviews on Foreign Acquisitions of US Business', Skadden, Arps, Slate, Meagher & Flom LLP, https://www.skadden.com/insights/implications-national-security-reviews-foreign-acquisitions-us-businesses-0 (last visited May 27 2014).

73 Mergers & Acquisitions Review, Full Year 2014, Legal Advisors, Thomson Reuters (2014), http://online.thomsonone.com.

74 Id.

75 'Hostile Takeovers Return', Financier Worldwide Magazine, August 2014, www.financierworldwide.com/hostile-takeovers-return/#.VWo4xGd0xaQ.

$221 billion, compared to $62 billion by August 2013.[76] The rise is attributed to a rise in boardroom confidence; as would-be targets trust that the worst of the economic downturn is behind them and that stock prices will remain high, they resist friendly bids in an attempt to increase premiums, pushing their would-be purchasers to turn hostile.[77] On the flip side, confident in their stability and the value of their stock and wanting to seize the currently low interest rates, would-be acquirers approach companies they had contemplated taking over during the downturn.[78] By June 2014, hostile M&A represented 19 per cent of worldwide M&A, with a combined value of $290 billion.[79] That said, $119 of that amount was attributable to Pfizer's Inc hostile, but later abandoned, bid for AstraZeneca, and by August, only $10 billion of hostile M&A had actually been completed.[80] Still, by year's end, hostile M&A represented close to 16 per cent of US M&A activity.[81]

Additionally, more hostile deals were completed in the last quarter of 2014, and, notwithstanding the success rate, the rise in hostile offers contributed to the rise in M&A deal numbers both by increasing the number of deals announced and by pushing along deals consummated in an attempt to avoid hostile takeovers. The trend spread across a variety of sectors in M&A including the top three ranking sectors. In the energy and power sector, Halliburton Company took over Baker Hughes Inc after turning hostile in November 2014 in a deal worth $38.5 billion.[82] In health care, Actavis plc bought Allergan Inc in a friendly deal worth $66.4 billion which closed in December 2014, as Allergan Inc rushed to avoid a hostile takeover by Valeant Pharmaceuticals International.[83] The largest deal of the year occurred in the media and entertainment sector – Comcast Corporation's announced acquisition of Time Warner Cable Inc for $70.7 billion – and was a friendly deal, but was largely driven by Time Warner Cable's attempt to avoid

76 David Weidner, 'Investors Sent on a Wild Ride by Hostile Deals', MarketWatch, 15 August 2014, www.marketwatch.com/story/investors-sent-on-a-wild-ride-by-hostile-deals-2014-08-15.

77 'Hostile Takeovers Return', *supra* note 75; Arash Massoudi & Ed Hammond, 'Hostile Takeovers Rise to 14-Year High in M&A as Confidence Grows', *Financial Times*, 8 June 2014, www.ft.com/intl/cms/s/0/a8a8f608-eee5-11e3-8e82-00144feabdc0.html#axzz3bf9Wi3GP.

78 Id.; Weidner, 'Investors Sent on a Wild Ride by Hostile Deals', *supra* note 76.

79 Massoudi & Hammond, 'Hostile Takeovers Rise', *supra* note 77.

80 Weidner, 'Investors Sent on a Wild Ride by Hostile Deals', *supra* note 76.

81 Ariel Deckelbaum, Frances Mi, Joseph Friedman, Yashreeka Huq, Samuel Welt, Ryan Blicher & Alison Gurr, 'M&A at a Glance – 2014 Year-End Roudup', Paul, Weiss, Rifkind, Wharton & Garrison, 15 January 2015, www.paulweiss.com/practices/transactional/mergers-acquisitions/publications/ma-at-a-glance-(2014-year-end-roundup).aspx?id=19211.

82 Liz Hoffman & Alison Sider, 'Halliburton Turns Hostile on Baker Hughes', *Wall Street Journal*, 14 November 2014, www.wsj.com/articles/oil-price-slump-spurs-halliburton-baker-hughes-talks-1416000634.

83 Jonathan Rockoff, 'Actavis Agrees to Buy Botox Maker Allergan', *Wall Street Journal*, 17 November 2014, www.wsj.com/articles/actavis-agrees-to-buy-allergan-1416233901.

Charter Communications' hostile offer.[84] When the *Time Warner/Comcast* deal failed due to antitrust concerns, Charter Communications' came back with another hostile bid in 2015, for which the outcome is still unknown.

While early 2015 has already seen some high-profile hostile offers, such as the three-way hostile offer of Teva Pharmaceutical Industries Ltd for Mylan NV, as Mylan NV attempts to take over Perrigo Company, or Simon Property Group Inc's attempt to acquire Macerich Company, the trend is not at 2014 numbers though it continues to involve the pharmaceutical and telecommunications sectors, which are set to remain among the most active in 2015.

ii Shareholder activism

In 2013 shareholder activism went mainstream; in 2014, it went big. Perhaps emboldened by their rising prominence and success – activists saw a success rate of 72 per cent in proxy fights in 2014, up from 60 per cent in 2013 – activists have invested more, targeted larger companies and sought larger changes.[85] Sixty-seven activist funds held $93 billion in 2013 and 71 held $112 billion in 2014, with total assets under activist management reported to have passed $150 billion in 2014 and potentially $200 as of early 2015.[86] Those investments have allowed activists to target more companies with market capitalization over $10 billion than in the past five years and close to three times those with market capitalization over $25 billion, including iconic entities such as Apple Inc, PepsiCo, Inc, Amgen, Inc, Walgreens Co, DuPont (E.I. du Pont de Nemours and Company), Allergan, Inc, Yahoo! Inc, Bank of New York Mellon Corp and Hertz Global Holdings Inc.[87]

The magnitude of the changes sought by activists has also been more notable. Shareholder activists have sought to replace the majority of, or even entire, boards, rather

84 Jeremy Bogaisky, 'Comcast Is Set to Snatch Time Warner Cable Away From Charter in $45B Deal', Forbes, 13 February 2014, www.forbes.com/sites/jeremybogaisky/2014/02/13/comcast-to-acquire-time-warner-cable-for-45-billion/.

85 Steven Davidoff Solomon, 'As Activist Investors Gain Strength, Boards Surrender to Demands', New York Times, 14 October 2014, http://dealbook.nytimes.com/2014/10/14/as-activist-shareholders-gain-strength-boards-surrender-to-demands/?_r=0.

86 Ronald Orol & Paula Schaap, 'Insurgencies by the Numbers', Deal Pipeline, 26 December 2014, www.thedeal.com/content/restructuring/insurgencies-by-the-numbers.php; 'Activist Investing: An Annual Review of Trends in Shareholder Activism', Schulte Roth & Zabel, www.srz.com/files/News/21059d09-ca8a-4c8d-bf07-34c275d5781d/Presentation/NewsAttachment/044cced3-43e5-4c21-8036-b6b684c34e7c/Activist_Insight_SRZ_The_Activist_Investing_Annual_Review_2015.pdf (last visited 31 May 2015).

87 Id.; 'The Actavist Revolution: Understanding and Navigating a New World of Heightened Investor Scrutiny', J.P.Morgan, January 2015, https://www.jpmorgan.com/cm/BlobServer/JPMorgan_CorporateFinanceAdvisory_MA_TheActivistRevolution.pdf?blobkey=id&blobwhere=1320675764934&blobheader=application/pdf&blobheadername1=CacheControl&blobheadervalue1=private&blobcol=urldata&blobtable=MungoBlobs.

than seeking to elect one or two directors.[88] Rather than preventing takeovers, they have pushed their companies to acquire other companies or to sell themselves, a trend which nearly doubled in 2014 as compared to 2013.[89] Darden Restaurants, Inc, Oliver Garden's and Red Lobster's parent, saw its entire board of directors replaced when shareholders called a meeting to vote on the Red Lobster sale and the board of directors rushed the sale prior to the meeting. Activist hedge fund Starboard Value LP not only advocated against the sale, but convinced shareholders to replace the board of directors with its 12 nominees once the board of directors rushed to act prior to shareholders' expressing their preference.

Some activist shareholders' effects on companies have been indirect. Activist investor Carl Icahn, eBay Inc's sixth largest shareholder, advocated for eBay to split-off PayPal in a proxy fight, which he later agreed to drop in exchange for the addition of a board member of his selection.[90] In October 2014, however, eBay independently decided to spin-off PayPal. Pershing Square Capital Management LP, Allergan Inc's largest shareholder, called an Allergan shareholder meeting hoping to remove board members and obtain approval for an Allergan sale to Valeant Pharmaceutical International Inc, which had made a hostile bid. Allergan sold itself to Actavis plc, rushing to preempt the meeting.

Activist investors have been able to extend their reach this far due to the steady erosion of structural defences and there is a concern that the constant scrutiny imposed by shareholder activists may be distracting and cause boards of directors to lose sight of the big picture as they respond to immediate pressures.

iii Appraisal arbitrage

In the wake of the Dole Food Company, Inc (Dole), management buyout, which closed in the fourth quarter of 2013, it appears hedge funds may be adding the battle for appraisal rights to their activist repertoires.[91] As hedge funds sit on large reserves of cash, they continue to seek ways to earn returns. In today's low-interest rate environment, shareholders seeking appraisal rights can obtain a meaningful return, as they are generally entitled to the fair value of their shares plus statutory interest compounded quarterly from the effectiveness of the merger until the appraisal judgement is paid.[92] Delaware's statutory interest rate is generally the Federal Reserve discount rate plus 5 per cent and

88 'Activist Investing: An Annual Review of Trends in Shareholder Activism', *supra* note 86.

89 Id.

90 Deepa Seetharaman & Supantha Mukherjee, 'EBay Follows Icahn's Advice, Plans PayPal Spinoff in 2015', Reuters, 30 September 2014, www.reuters.com/article/2014/09/30/us-ebay-divestiture-idUSKCN0HP13D20140930.

91 Steven M. Davidoff, 'A New Form of Shareholder Activism Gains Momentum', New York Times, 4 March 2014, http://dealbook.nytimes.com/2014/03/04/a-new-form-of-shareholder-activism-gains-momentum/?_php=true&_type=blogs&_r=0.

92 William Savitt, 'Dissenters Pose Bigger Risks to Corporate Deals', *National Law Journal*, 10 February 2014, www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.23132.14.pdf.

is higher than any rate available in the market.[93] While appraisal rights are generally not a lucrative pursuit for the average shareholder, activist funds have the resources to make it worth their while and the values involved keeps rising. Appraisal arbitrage claims were valued at $1.5 billion in 2013, an eightfold increase from 2012.[94] In 2014, an unprecedented 33 appraisal claims were filed in Delaware courts, compared with 28 in 2013 and the most since 2004, if not earlier.[95] Approximately 81 per cent of Delaware appraisals that went to trial since 1993 obtained higher prices.[96]

A recent Delaware Court of Chancery decision failed to ensure these appraisal arbitrage claims only protect the minority of shareholders who did not favor a deal when it found that there was no requirement that the claimant show the specific shares it seeks appraisal of voted against the deal.[97] The claimant must instead only show that more shares were voted against the merger than the number of shares it seeks appraisal of, leaving open the door for use of the practice by hedge funds.[98]

A 2015 amendment approved by the Executive Committee of the State of Delaware Bar Association, but not yet passed into law, proposes two changes to curb the amounts involved in appraisal arbitrage. The first amendment to Section 262 of the DGCL would impose a *de minimis* exception, allowing only claims where either (i) more than 1 per cent of the outstanding shares entitled to appraisal perfect their appraisal rights or (ii) the value of the merger consideration for the shares with perfected appraisal rights exceeds $1 million. The provision would not apply to certain short-form mergers and would apply only to shares listed on a national exchange. The second amendment to Section 262 would allow a corporation to prepay the claimant any portion of the transaction price, therefore limiting the principal on which interest accrues while the claim is disputed. The amendment has not yet been passed and it still fails to prevent appraisal arbitrage by parties who may have voted in favour of a deal and who subsequently seek appraisal of all their shares to obtain the settlement (companies settling with arbitrageurs to prevent litigation) or interest benefits.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Credit markets failed to show the same vigour in 2014 as the previous year. US debt capital markets saw a decrease in high-yield debt issuances, with 2014 proceeds down

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93 Id.

94 Liz Hoffman, 'Hedge Funds Wield Risky Legal Ploy to Milk Buyouts', *Wall Street Journal*, 13 April 2014, http://online.wsj.com/news/articles/SB10001424052702303887804579500013770163966.

95 Liz Hoffman, 'Judges Rules in Favor of Hedge Fund 'Appraisal Arbitrage' Strategy', *Wall Street Journal*, 7 January 2015, www.wsj.com/articles/judge-rules-in-favor-of-hedge-fund-appraisal-arbitrage-strategy-1420571897.

96 Id.

97 *In re Appraisal of Ancestry.com, Inc.*, C.A. No. 8173-VCG (Del. Ch. Jan. 5, 2015) and *Merion Capital LP v. BMC Software, Inc.*, C.A. No. 8900- VCG (Del. Ch. Jan. 5, 2015).

98 Id.

6.0 per cent as compared to 2013, for a total of $307.4 billion.[99] 2014 dollar volume of US investment grade debt issuances inched past 2013's all-time high, exceeding the $1 trillion mark for the third year in a row with $1.1 trillion, up 9 per cent from the previous year.[100] Overall US syndicated lending was stagnant from 2013, up 1 per cent over 2013 levels, with total dollar volume of $2.3 trillion.[101] US leveraged lending slightly decreased from 2013, which was the best year since the credit boom, with US leveraged loan volume dropping down 7 per cent from $1.22 trillion to $1.2 trillion.[102] Unlike the previous year, bolstered by a single transaction (Verizon Communications Inc's acquisition of Verizon Wireless Inc), 2014 was driven by multiple mega-deals in the financing realm as well as the M&A realm. The top three financings were Actavis plc's acquisition of Allergan Inc with a syndicated loan of $36.4 billion, followed by Medtronic Inc's $16.3 billion loan to purchase Covidien PLC and Merck KGaA's $15.6 billion loan to acquire Sigma-Aldrich Corp.[103] On the bond side, there were 23 bond deals over $5 billion worldwide in 2014, more than double the number from 2013, with Medtronic Inc's $17 billion offering and Apple Inc's $12 billion representing two of the top 10 deals on record.[104] The bond market was heavily driven by M&A activity, with acquisition-related bond deals in 2014 representing half the largest corporate bond sales.[105]

Syndicated lending crashed at the start of 2015, with first quarter overall US syndicating lending and US leveraged loan values decreasing 17.2 per cent and 51 per cent, respectively, as compared to the first quarter of 2014.[106] Debt capital markets saw a further surge in investment grade debt, up 7.9 per cent compared to the first quarter of 2014, resulting in the first largest quarterly volume on record, largely caused by the funding of Actavis plc's funding, which was the second largest bond issue on record.[107]

Despite overall stagnant credit markets, total 2014 M&A-related loan volume reached a seven-year high with $254.4 billion, the most since it reached its peak

99 Debt Capital Markets Review, Full Year 2014, Managing Underwriters, Thomson Reuters (2015), http://online.thomsonone.com.

100 Id.

101 Global Syndicated Loans Review, Full Year 2014, Managing Underwriters, Thomson Reuters (2014), http://online.thomsonone.com.

102 Id.

103 Id.

104 Sarah Krouse & Matt Turner, 'Jumbo Corporate Bond Deals Find Broad Base', Wall Street Journal, 16 December 2014, http://blogs.wsj.com/moneybeat/2014/12/16/jumbo-corporate-bond-deals-find-broad-base/.

105 Id.

106 Global Syndicated Loans Review, First Quarter 2015, Managing Underwriters, Thomson Reuters (2015), http://online.thomsonone.com.

107 Debt Capital Markets Review, First Quarter 2015, Managing Underwriters, Thomson Reuters (2015), http://online.thomsonone.com.

in 2007 with $331 billion.[108] Refinancings, which represented nearly half of US leveraged loan volume in 2013, fell from $287.3 billion to $169 billion, and dividend recapitalisation fell from its record $69.9 billion to $53.2 billion.[109]

Due to US regulators making their stance on excessive borrowing clear, with guidelines published in March 2013 (and letters sent directly to big banks in the summer of 2013) placing pressure on banks to hold the line on total leverage ratios of six times, non-bank lenders have somewhat replaced banks in the buyout market.[110] However, while the number of leveraged buyouts has dropped, the leverage buyout ratios are close to the 2007 levels.[111] Private equity firms paid an average of 9.7 times their target companies' trailing 12 months EBITDA in 2014, close to the 9.8 times they paid in 2007.[112] The trend is expected to drop, and has already done so, in 2015. As of the end of March 2015, US buyouts were at the lowest deal number for the first quarter since 2010 and the lowest dollar volume for the first quarter since 2012.[113] Private equity firms are also constrained by and concerned about regulations on leveraged ratios, and private equity deals financed with leveraged dropped in early 2015 to 21 per cent from 35 per cent from the fourth quarter of 2014 and is expected to drop further.[114]

VII EMPLOYMENT LAW

As a result of recent regulatory changes in the US, including the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in 2010 and the SEC regulations implementing that legislation, some of which are still forthcoming, shareholders of publicly traded companies in the US have been granted increased disclosure, and a louder voice, regarding the material components of such

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108 'Credit Markets Quarterly, 4th Quarter 2014', KPMG Corporate Finance LLC (2015), https://www.kpmg-institutes.com/content/dam/kpmg/globalenterpriseinstitute/pdf/2015/q4-2014-credit-markets-quarterly-update.pdf.

109 Id; 'Credit Markets Quarterly, 4th Quarter 2013', KPMG Corporate Finance LLC (2014), www.kpmginstitutes.com/advisory-institute/insights/2014/pdf/credit-markets-quarterly-update-2013-q4.pdf.

110 Gillian Tan, 'Banks Sit out Riskier Deals', *Wall Street Journal*, 21 January 2014, http://online.wsj.com/news/articles/SB100014240527023043027045793348202015300 10, Sasha Dai, 'Deal Multiples for Leveraged Buyouts Reach 2007 Levels', *Wall Street Journal*, 31 December 2014, http://blogs.wsj.com/privateequity/2014/12/31/deal-multiples-for-leveraged-buyouts-reach-2007-levels/.

111 Dan Primack, 'Where Did All the Big Buyouts Go?', Fortune, 3 November 2014, http://fortune.com/2014/11/03/where-did-all-the-big-buyouts-go/; Dai, 'Deal Multiples for Leveraged Buyouts Reach 2007 Levels', *supra* note 110.

112 Dai, 'Deal Multiples for Leveraged Buyouts Reach 2007 Levels', *supra* note 110.

113 Gillian Tan, 'Buyout Firms Feel Pinch From Lending Crackdown', *Wall Street Journal*, 25 March 2015, www.wsj.com/articles/buyout-shops-feel-pinch-from-lending-crackdown-1427304125.

114 Id.

companies' executive pay practices (including an advisory vote known as a say-on-pay or SOP vote). SOP votes on executive compensation provide a platform from which shareholders may voice their opinions about executive pay practices employed by the company. Over the past five proxy seasons in which the SOP regulations have been in effect, certain patterns and practices have emerged as new standards, although the long-term effects of the regulatory changes remain unclear.

i Say-on-pay votes and compensation adjustments

Although SOP votes are non-binding, companies have generally demonstrated concern for their outcomes. During 2012, 58 Russell 3000 companies received 'failed' SOP votes (defined as receiving 50 per cent or fewer votes in support, excluding abstentions), and during 2013 and 2014, 58 and 60 Russell 3000 companies, respectively, received failed SOP votes, many after a proxy adviser such as Institutional Shareholder Services (ISS) and Glass, Lewis & Co had recommended a 'no' vote.[115] As of late May 2015, 21 Russell 3000 companies had failed SOP votes, compared to eight Russell 3000 companies that had failed SOP votes as of mid-May 2014, and 9 per cent of companies received 'no' recommendations from ISS, as of late May 2015, compared to 11 per cent as of mid-May 2014.[116] Notably, as of mid-May 2015, only 14 Russell 3000 companies have failed SOP votes in more than one of the five proxy seasons in which the SOP regulations have been in effect, and, on average, Russell 3000 companies that have failed a SOP vote in a given year have seen a 38 per cent increase in shareholder support for the SOP proposal the following year. The small number of companies that have failed a SOP vote in multiple proxy seasons, and the significant increase in shareholder support for a SOP proposal in the year following a failed SOP vote, demonstrates that companies approach a failed SOP vote seriously and, in most instances, make substantive changes to their pay practices in response to investor concerns voiced through such failed vote.

Data suggest that companies with high CEO pay or low stock price performance, in each case, relative to their peer companies, are consistently the ones most at risk of a failed SOP vote.[117] Companies were increasingly focused on addressing this concern in recent proxy seasons, and a survey following the 2014 proxy season found that

115 Frederic W Cook & Co, Inc, 'Executive Compensation 2012 Year in Review and Implications for 2013 and Beyond', 1 April 2013, at 1, www.fwcook.com/alert_letters/04-01-13_Executive_Compensation_2012_Year_in_Review_and_Implications_for_2013_and_Beyond.pdf; '2015 Say on Pay Results', Semler Brossy, 27 May 2015, at 3, www.semlerbrossy.com/wp-content/uploads/SBCG-2015-SOP-Report-2015-05-27.pdf. As of May 27, 2015, shareholder support for SOP proposals was 32 per cent lower at companies that received a 'no' recommendation from ISS.

116 '2015 Say on Pay Results', *supra* note 115; '2014 Say on Pay Results', Semler Brossy, 7 May 2014, at 6, www.semlerbrossy.com/wp-content/uploads/SBCG-2014-Say-on-Pay-Report-2014-05-07.pdf.

117 'How Much Does Performance Count in a Say-on-Pay Vote?', Semler Brossy, 7 January 2015, www.semlerbrossy.com/insights/how-much-does-performance-count-in-a-say-on-pay-vote/; '2014 Say-on-Pay Results, Report Update: Five Additional Companies With Support Below

companies overwhelmingly expressed their intentions to strengthen the link between pay and performance, as well as conduct a pay-for-performance analysis.[118] Indeed, many companies have altered their pay practices, at least with respect to their CEOs, presumably as a reaction to a real or perceived sense of low shareholder support for the existing programme, and there has been a noticeable shift, particularly among the largest companies, toward incentive-based pay, with more than 75 per cent of aggregate CEO compensation at companies in the S&P 1500 comprised of equity and performance-based short-term incentives.[119]

The SOP regulations have similar application to M&A transactions. Regulations grant to shareholders an advisory vote (a 'say on golden parachute' or 'SOGP' vote) approving the amounts to be paid to executives upon a change in control (triggered by most types of M&A transactions). Certain change in control benefits that historically have been relatively common in connection with such transactions (e.g., 'single-trigger' acceleration of equity-based awards and gross-ups for the golden parachute excise tax pursuant to Section 280G of the US Internal Revenue Code, which applies to certain transaction-related payments above a threshold) have been singled out by proxy advisory firms and have drawn the particular ire of shareholders.[120] ISS's published policy guidance clearly states that it will render a negative SOP vote recommendation or a 'withhold' vote recommendation for the election of directors when a 280G gross-up is included in a new change-in-control agreement, even if no M&A transaction is imminent at the time such agreement is signed.[121] In addition, more recently ISS has indicated that it will consider legacy excise-tax gross-up and single-trigger acceleration provisions in determining its recommendation on SOGP proposals.[122]

50%', Semler Brossy, 16 July 2014, at 2, www.semlerbrossy.com/wp-content/uploads/SBCG-2014-Say-on-Pay-Report-2014-07-161.pdf.

118 Stephen Miller, 'Companies Strengthen Pay-for-Performance Analyses', Society for Human Resource Management, 5 November 2014, www.shrm.org/hrdisciplines/compensation/articles/pages/pay-for-performance-factors.aspx#sthash.5oio42Ss.dpuf.

119 'Upon Closer Inspection, CEO Pay Increasingly Performance-Based', Towers Watson, 16 December 2013, www.towerswatson.com/en-US/Insights/Newsletters/Global/executive-pay-matters/2013/Executive-Compensation-Bulletin-Upon-Closer-Inspection-CEO-Pay-Increasingly-Performance-Based.

120 Cody Nelson, 'Executive Compensation Bulletin: The Changing Landscape of Golden Parachutes in a Say-on-Pay World', Towers Watson, 28 May 2015, www.towerswatson.com/en/Insights/Newsletters/Global/executive-pay-matters/2015/Executive-Compensation-Bulletin-The-Changing-Landscape-of-Golden-Parachutes-in-a-Say-on-Pay-World. The existence of these pay practices presents risks to a favorable SOGP or SOP vote, and such practices are particularly highlighted in the SOGP disclosure.

121 ISS 2015 U.S. Compensation Policy FAQ, Q&A 59, www.issgovernance.com/file/policy/2015comprehensivecompensationfaqs.pdf.

122 ISS 2015 U.S. Compensation Policy FAQ, Q&A 75, www.issgovernance.com/file/policy/2015comprehensivecompensationfaqs.pdf.

Interestingly, the most recent data on investor decisions suggest a possible decrease in the influence of proxy advisors on investor voting.[123] For example, of the 131 SOGP votes in 2014, 93.89 per cent passed, although ISS recommended against 23 per cent of SOGP proposals in that year.[124] Furthermore, many of the most important institutional investors, including Blackrock and Vanguard, have formed in-house proxy analysis and governance groups to inform their own voting decisions in lieu of depending on proxy advisory firms. [125]

ii Shareholder litigation

Through litigation, emboldened shareholders are applying increased formal pressure on companies to change their executive pay and disclosure practices. Following the adoption of the SOP regulations, the first wave of shareholder litigation focused on SOP votes that achieved less than 70 per cent support,[126] and recent shareholder litigation has additionally challenged director compensation, although not subject to a shareholder vote, specifically alleging insufficient equity plan limits on awards to directors.[127]

A flurry of plaintiff shareholder challenges to independent director compensation arose in 2014. One of these suits, *Calma v. Templeton* (more commonly referred to as *Citrix*), resulted in a change in black letter law favouring plaintiffs.[128] In *Citrix*, the Delaware Chancery Court ruled that the relatively plaintiff-friendly 'entire fairness' standard of review rather than the relatively defendant-friendly 'business judgment rule' applied to the plaintiff's derivative claim that Citrix Systems' grants of restricted stock units to its non-employee directors under its shareholder-approved equity compensation

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123 Jeff McCutcheon, '2014 Trends in Executive Compensation and Governance', Board Advisory, Retrieved from www.board-advisory.com/2014-trends-in-executiv e-compensation-and-governance.

124 ISS Corporate Solutions Governance Analytics, https://ga.isscorporateservices.com. The number of votes passed increased from 86 per cent in 2013.

125 'Lessons learned and Hot Topics in Executive Compensation', Grant Thornton LLP, 29 April 2015, at 10, https://www.grantthornton.com/~/media/content-page-files/tax/pdfs/archived-webcasts/2015/04-29-hot-topics-exec-compensation.ashx; Susanne Craig, 'The Giant of Shareholders, Quietly Stirring', The New York Times, 18 May 2013, www.nytimes.com/2013/05/19/business/blackrock-a-shareholding-giant-is-quietly-stirring.html?_r=0; Joann S. Lublin and Kirsten Grind, 'For Proxy Advisers, Influence Wanes', *Wall Street Journal*, 22 May 2013, www.wsj.com/articles/SB1000142412788732333610457849955414379319.

126 ISS has designated 70 per cent as the threshold amount of support a company must receive in order for its SOP vote to be considered successful.

127 While typically directors' responsibilities, including setting their own compensation, have been protected under the business judgment rule, in *Seinfeld v. Slager*, Civil Action No. 6462-VCG (Del. Ch., filed 29 June 2012) the Delaware Chancery Court denied a motion to dismiss a claim that the directors breached their fiduciary duties by granting themselves equity awards under a shareholder-approved plan due to insufficient limits on the amount of pay that could be awarded to directors.

128 See *Calma v. Templeton*, 2015 Del. Ch. LEXIS 126 (Del. Ch. Apr. 30, 2015).

plan, when combined with cash payments, were excessive in comparison to the compensation of similarly situated directors of peer corporations.[129] The Court rejected Citrix's argument that its shareholders had ratified the compensation packages through approval of the equity compensation plan because the approved plan did not address the non-employee director compensation with sufficient specificity, even though the Citrix plans were drafted in a market-customary fashion.

iii Compensation activity in connection with corporate inversion

As previously mentioned, 2014 saw a significant increase in the number of US companies engaging in corporate inversions.[130] In 2004, Congress enacted Sections 7874 and 4985 of the US Tax Code in a push to contain the rising corporate inversion trend. These two statutes heightened the complexity of executive compensation within corporate inversion transactions. Section 7874 defines what constitutes a corporate inversion, and is further discussed below (in the section on tax law).

Section 4985 imposes a 15 per cent excise tax on stock options, restricted stock units, and other equity-based compensation held by US executives six months before and six months after the closing of an inversion transaction, unless the equity compensation is paid prior to the closing. To shield executives from this penalty, companies either engage in 'gross-ups' where they increase payouts to executives to cover their tax liabilities, or provide vesting and payment of the equity compensation prior to the closing of a deal.[131] Corporations more frequently choose the former option of grossing-up, and in some cases this tactic has resulted in shareholder dissatisfaction.[132] For example, in the 2014 Medtronic-Covidien inversion, Medtronic shareholders, including two Medtronic ex-directors and the head of Franklin Mutual Series Funds, expressed anger at the fact that top Medtronic executives would receive approximately $63 million in gross-up payments, whereas Medtronic shareholders were being forced to pay significant capital gains taxes in connection with the deal.

Though gross-up strategies associated with Section 4985 are similar to the previously discussed ISS-disapproved Section 280G gross-ups, ISS has not generally issued adverse recommendations as a result of them. Without the specter of eliciting negative ISS votes, companies have continued to use gross-ups in connection with corporate inversions.

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129 Id.

130 'What's Market: 2014 Public M&A Wrap-up', *supra* note 11.

131 Lawrence Hsieh, 'Corporate Inversions Back in The News Again', *The Economist Insights,* 11 May 2015, www.economistinsights.com/opinion/corporate-inversions-back-news-again; Rakesh Sharma, 'Medtronic Avoids U.S. Taxes While Saddling Shareholders With a Hefty Tax Bill', *The Street*, 28 January 2015, www.thestreet.com/story/13024863/1/medtronic-avoids-us-taxes-while-saddling-shareholders-with-a-hefty-tax-bill.html.

132 Ajay Gupta, 'News Analysis: Grossing Up an Inversion Tax', *Tax Analysts*, 4 September 2014, www.taxanalysts.com/www/features.nsf/Features/75722BEE3E877D1685257D4F00603223?OpenDocument.

iv Looking ahead

Although predictions are always hazardous, the movements of the last few years point to areas that are almost certain to see interesting developments in the near future as a result of the changes described above. The most significant shift may emerge in the increasing engagement of companies with shareholders, as companies are expected to seek shareholder feedback on compensation programme design with greater frequency and focus on addressing the disparity between investor and management perceptions with respect to executive compensation.[133] Further changes in compensation practices may be fuelled by the ultimate adoption of SEC rules required under Dodd-Frank relating to the link between executive pay and company financial performance, as well as expected rulemaking on disclosing the ratio of CEO pay to average employee pay.[134]

Going forward, while golden parachutes will remain a feature of executive compensation, given increased shareholder activism and pressure from proxy advisers to limit excessive compensation package strategies, it is likely that companies may begin to converge toward 'a new normal' for such payments.[135] Shareholders are also likely to continue exploring other avenues for influencing the pay practices of unresponsive companies. Thus far, director re-election has not been significantly affected by failed SOP votes, although shareholders increasingly express frustration over compensation practices by voting against re-election of directors, particularly those involved in compensation decisions.[136] The practices identified as most troublesome by ISS and other proxy

133 'Shareholder Engagement: A Key Component of Improved Say-on-Pay Outcomes in 2014', Towers Watson, 12 March 2014, www.towerswatson.com/en-US/Insights/Newsletters/Global/executive-pay-matters/2014/Shareholder-Engagement-A-Key-Component-of-Improved-Say-on-Pay-Outcomes-in-2014.

134 U.S. Securities and Exchange Commission, 'SEC Proposes Rules for Pay Ratio Disclosure', 18 September 2013, www.sec.gov/News/PressRelease/Detail/PressRelease/1370539817895; U.S. Securities and Exchange Commission, 'SEC Staff Provides Additional Analysis Related to Proposed Pay Ratio Disclosure Rules', 4 June 2015, www.sec.gov/news/pressrelease/2015-109.html; Steve Seelig, Puneet Arora & Bill Kalten, 'SEC's Proposed Pay-for-Performance Disclosure Rules Will Require Companies to Perform New Pay Calculations', Towers Watson, 29 April 2015, www.towerswatson.com/en/Insights/Newsletters/Global/executive-pay-matters/2015/SECs-Proposed-Pay-for-Performance-Disclosure-Rules-Will-Require-Companies-to-Perform-New-Pay-Calcs.

135 Cody Nelson, 'Executive Compensation Bulletin: The Changing Landscape of Golden Parachutes in a Say-on-Pay World', Towers Watson, 28 May 2015, PDF available at: www.towerswatson.com/en/Insights/Newsletters/Global/executive-pay-matters/2015/Executive-Compensation-Bulletin-The-Changing-Landscape-of-Golden-Parachutes-in-a-Say-on-Pay-World.

136 Devika Krishna Kumar & Ross Kerber, 'Three Google Directors Survive Challenge Over Pay', Reuters, 3 June 2015, www.reuters.com/article/2015/06/03/us-google-compensation-iss-idUSKBN0OJ1LC20150603; Christina Rexrode & Peter Rudegeair, 'Bank of America Shareholders Rebuke Director', *Wall Street Journal*, 7 May 2015, www.wsj.com/articles/one-third-of-bank-of-america-investors-vote-against-board-member-tom-may-1431033680.

advisory firms likely will continue to disappear given the influence of proxy advisory firms on the outcome of SOP and SOGP votes, and compensation, even with respect to perquisites and other fringe benefits, is expected to continue to shift away from cash to equity and performance-based awards. It is unclear what the effect of the migration to equity and performance-based pay, coupled with the elimination of single-trigger vesting and increased shareholder engagement, will have on future M&A transactions.

VIII TAX LAW

As noted above in Section IV, last year, inversion transactions – i.e., transactions in which US companies reincorporate abroad as part of a strategic acquisition transaction – dominated the M&A landscape. Increasingly, lawmakers took note and planned a response. Three major pronouncements have come since then, and most practitioners believe more will follow. First, the IRS and Treasury Department issued a notice with important new rules governing inversions. Second, the Obama administration proposed a new series of taxes on offshore earnings of US multinational companies. Third, the Treasury Department issued proposed model treaty language that, if implemented, would affect various international tax arrangements, including those applicable to inverted companies.

i IRS Notice 2014-52

The first attempt to stem the inversion tide came on 22 September 2014, when the IRS and Treasury Department released Notice 2014-52 (the Notice). The Notice announced the US government's plan to promulgate regulations designed to do two things: (1) make it more difficult for US companies to complete inversion transactions; and (2) decrease the tax benefits arising from inversions. The Notice applies to transactions occurring on or after 22 September 2014; as a result, several planned transactions that had not yet closed (including, as discussed in Section IV, *Cosmo/Salix* and *AbbVie/Shire*) were terminated.

Recall that an inversion transaction is a business combination between a US company and a foreign company in which both companies' shareholders become shareholders in a foreign corporation. Often, a new foreign holding company (foreign holdco) is formed to acquire the US company and the foreign company. One important requirement for an inversion transaction is that the shareholders of the US company must own less than 80 per cent of the stock of the foreign holdco (by vote and value) after the transaction.

The Notice makes it more difficult to keep the US shareholders under this 80 per cent threshold in two ways. First, in an 'anti-shrinking' rule, the Notice sets forth a complicated mechanical test for disregarding a portion of the US company's distributions in the three years before the transaction. The idea is to prevent US companies from 'shrinking' by paying large dividends (or completing large share repurchases) in advance of the transaction. Second, in an 'anti-stuffing' rule, the Notice provides that if the foreign target has more than 50 per cent gross assets consisting of cash, marketable securities and other similar assets, then a proportionate share of the foreign holdco stock issued to the foreign company shareholders will be disregarded. This rule is designed to prevent the creation of a foreign 'cash box' that is later used as vehicle with which a US company can complete an inversion – such as the inversion between Perrigo Company and Elan Corporation plc, in which Elan (the smaller Irish company) had previously sold many of its business assets for cash.

In addition to making it more difficult to invert in the first place, the Notice also makes it less beneficial to do so. Before the Notice, one clear benefit of inverting was that it allowed the US company to access foreign earnings without subjecting them to US tax. This could be achieved by loaning 'trapped cash' held by the foreign subsidiary up to the foreign holdco or one of its foreign affiliates. Under the Notice, however, it is virtually impossible for US companies to access trapped cash; such a loan would be taxed as a deemed repatriation of that cash into the United States, triggering a US tax. And the Notice creates a similar 'deemed dividend' rule for other techniques that would result in the transfer of a foreign subsidiary out from under the US company. As a result, one of the key short-term value drivers of inversions – the ability to access 'trapped cash' with minimal or no US tax cost – has now been curtailed.

In addition to these changes, the Notice also warned that the IRS and Treasury Department were reviewing other techniques often used in conjunction with inversions, such as 'earnings stripping' and sophisticated treaty planning. Ominously, the Notice indicated that future rules limiting the use of those techniques may apply retroactively to inversion transactions completed on or after 22 September 2014.

ii New revenue proposals

In February 2015, five months after the Notice was issued, the Treasury Department released its Fiscal Year 2016 Revenue Proposals (the Revenue Proposals).[137] The Revenue Proposals include tax reforms that, if implemented, would have important implications for US corporations with foreign subsidiaries.

The Revenue Proposals are aimed at taxing the 'trapped cash' discussed above. US corporations are taxed on income earned worldwide, but when a US-based multinational corporation earns income through a foreign subsidiary, that income generally is not taxed in the United States until the subsidiary repatriates the income as a dividend or a loan to the US parent. Predictably, this policy (along with favourable financial accounting treatment) creates incentives for corporations to reinvest offshore earnings in ongoing foreign operations rather than bringing that cash back to the United States. Because the United States has one of the highest top marginal corporate income tax rates in the world, the benefits of deferring taxation can be substantial.

The Revenue Proposals reduce the top marginal corporate income tax rate from 35 per cent to 28 per cent for all US corporations and finance that rate cut by eliminating the deferral on unrepatriated offshore earnings. Foreign earnings instead would be taxed on a current basis at a minimum rate of 19 per cent, with a credit for 85 per cent of foreign taxes already paid. Thus, a subsidiary earning income in any country with an

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137 U.S. Dep't of the Treasury, General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals, February 2015, www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx.

effective tax rate greater than 22.35 per cent would pay no US tax; tax paid abroad at an effective rate less than 22.35 per cent would be 'topped up' with US tax to meet the 19 per cent minimum. No additional US tax would be imposed if offshore profits ultimately are repatriated.[138] This new tax on future foreign profits would generate an estimated $238 billion over the next ten years.[139] This is no small amount, either in absolute or relative terms; as a point of reference, the federal government raised just under $321 billion in income tax from all corporate taxpayers in 2014, up from $274 billion in 2013.[140]

Additionally, the Revenue Proposals include a one-time 14 per cent tax on the $2.119 trillion[141] in previously untaxed accumulated offshore profits.[142] This one-time tax would generate an estimated $268 billion over the next 10 years,[143] which would be used to fund part of a $478 billion infrastructure project.[144]

If the Revenue Proposals become law, corporations with the largest offshore cash stockpiles – such as Microsoft, Pfizer and Apple, which held at least $76.4, $69.0, and $54.4 billion in unrepatriated profits in 2013, respectively[145] – would face a massive, unanticipated tax bill. Although affected companies would have five years to pay the one-time tax bill,[146] those that have reinvested their foreign profits in ongoing operations and have little cash actually on hand could face considerable cash-flow issues.[147]

The Revenue Proposals have been met by an overwhelmingly critical response by policy analysts, financial journalists, and executives of multinational corporations

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138 Id. at 21.

139 Katherine Chiglinsky & Thomas Black, 'GE, Pfizer Face $506 Billion Foreign-Cash Tax in Obama Plan', BloombergBusiness, 2 February 2015, www.bloomberg.com/news/articles/2015-02-02/ge-microsoft-face-506-billion-foreign-profit-tax-in-obama-plan.

140 U.S. Dep't of the Treasury, Monthly Treasury Statement of Receipts and Outlays of the United States Government 5 tbl.3 (2014), www.fiscal.treasury.gov/fsreports/rpt/mthTreasStmt/mts0914.pdf.

141 Nick Timiraos & John D. McKinnon, 'Obama Proposes One-Time 14% Tax on Overseas Earnings', *Wall Street Journal*, 2 February 2015, www.wsj.com/articles/obama-proposes-one-time-14-tax-on-overseas-earnings-1422802103 (see figure titled 'Piling Up,' graphing annual trends in 'foreign indefinitely reinvested earnings').

142 2016 Revenue Proposals, *supra* note 137, at 23.

143 Chiglinsky & Black, 'GE, Pfizer face $506 Billion Foreign-Cash Tax in Obama Plan', *supra* note 139.

144 2016 Revenue Proposals, *supra* note 137, at 23.

145 Rupert Neate, 'Barack Obama Sets Out Plan to Tax US Companies on $2tn Profits Held Abroad', Guardian, 2 February 2015, www.theguardian.com/us-news/2015/feb/02/barack-obama-tax-profits-president-budget-offshore (quoting statistical analysis by Capital Economics).

146 2016 Revenue Proposals, *supra* note 137, at 23.

147 Kyle Pomerleau, 'The President's Tax on Offshore Earnings Represents the Worst of Retroactive Tax Policy', Tax Policy Blog, 2 February 2015, http://taxfoundation.org/blog/president-s-tax-offshore-earnings-represents-worst-retroactive-policy.

holding substantial amounts of offshore cash. Commentators observe that US-based multinational corporations already operate at a disadvantage compared to competitors based in countries with territorial tax systems and argue that imposing new taxes on US companies will only further encourage those companies to pursue inversions.[148] Additionally, they point out that taxing domestic earnings at 28 per cent and foreign earnings at 19 per cent would penalise US corporations that earn more income domestically relative to peer corporations with multinational operations.[149] Others decry the one-time 14 per cent tax on accumulated offshore profits as an unfair retroactive tax that 'would subject decades' worth of past economic decisions by these businesses to taxation' and 'may make taxpayers question the stability of tax laws and regulations going forward.'[150]

In any event, most political commentators think that the proposed reforms are unlikely to be enacted by the current Congress, both houses of which are controlled by Republicans. One commentator described the proposals as a 'game that politicians of both parties...have been playing for years';[151] another described them as 'dead on arrival in Congress.'[152]

iii Proposed treaty changes

As mentioned above, in Notice 2014-52, the IRS and Treasury warned of future guidance aimed at curtailing reliance on US income tax treaties in structures that erode the US tax base. One example of such a structure involves 'earnings stripping,' a technique used commonly by foreign companies (including foreign companies resulting from inversions) that have US subsidiaries. Earnings stripping involves a US subsidiary of the foreign company issuing debt to its foreign parent company (or one of its foreign affiliates). Subject to certain limitations, the interest on the debt is deductible in the United States, providing a 35 per cent federal tax benefit, but is taxed in the hands of the affiliate at a much lower rate (depending on the local rules of the affiliate's jurisdiction). Moreover, under the income tax treaty between the United States and the affiliate's jurisdiction, the

148 See, e.g., David Kocieniewski, 'Companies Too Big to Invert Would Take Brunt of Obama Tax Plan', *BloombergBusiness*, 4 February 2015, www.bloomberg.com/news/articles/2015-02-04/companies-too-big-to-invert-would-take-brunt-of-obama-tax-plan; Tiernan Ray, 'Intel CFO: Obama Repatriation Tax Proposal 'Lipstick on a Pig', Barron's, 4 February 2015, http://blogs.barrons.com/techtraderdaily/2015/02/04/intel-cfo-obama-repatriation-tax-proposal-lipstick-on-a-pig (interview with Intel's CFO, Stacy Smith).

149 See Howard Gleckman, 'Do Obama's Corporate Tax Proposals Add Up?', *Forbes*, 4 February 2015, www.forbes.com/sites/beltway/2015/02/04/do-obamas-corporate-tax-proposals-add-up.

150 Pomerleau, 'The President's Tax on Offshore Earnings', *supra* note 147.

151 Id.

152 Jeremy Scott, 'Obama's Foreign Earnings Tax: 19% Minimum DOA but Deemed Repatriations Key', *Forbes*, 5 February 2015, www.forbes.com/sites/taxanalysts/2015/02/05/obamas-foreign-earnings-tax-19-minimum-doa-but-deemed-repatriations-key.

US withholding tax rate on interest is zero per cent, and so the structure results in no US tax on the interest paid offshore.

On 20 May 2015, the IRS and Treasury announced new proposed model treaty provisions to combat this sort of planning. While certain provisions are clearly aimed at inversions, others would apply more generally. For example, a significantly revised article governing 'limitations on benefits' (LOB) would change drastically which foreign companies are eligible for benefits of US treaties. Under the proposed LOB provisions, publicly traded companies resident in a foreign country would be eligible for treaty benefits only if either (1) the company's shares are 'primarily traded' on an exchange located in the foreign country or (2) the 'primary place of management and control' is in the foreign country. On (1), this means that companies traded primarily on NYSE or NASDAQ would not qualify for treaty benefits. On (2), note that the 'primary place of management and control' test is very different from 'effective management and control' under many local foreign laws. The latter often looks mainly (if not exclusively) to where board meetings take place; the former, however, is defined in the model treaty itself, and generally requires that executives and management of the foreign company (and their administrative and support staffs) work more in the foreign country of residence than anywhere else.

For inverted US companies now operating as foreign companies, these heightened LOB requirements are likely to create serious commercial and operational issues. Many inverted companies continue to be traded on NYSE or NASDAQ, so the 'primarily traded' test will not be met. (Meeting it would require listing on a foreign exchange and having that exchange be the primary place of trading, which may be commercially and financially undesirable for companies and investors alike.) And as for moving management and staff overseas to satisfy the 'primary management and control' test, this generally has not been the practice of inverted companies.

These revised LOB provisions are clearly an attempt by the IRS and Treasury to make sure that foreign companies benefit from US income tax treaties only if they have more significant substance abroad than is required under current law. They are clearly aimed, at least in part, at US companies that have reorganised overseas by completing inversion transactions. Nevertheless, the LOB provisions themselves would apply to any foreign company, inverted or not, seeking to benefit from a treaty containing such an LOB provision.

Aside from the LOB provisions, which would apply to all foreign companies, the revised model treaty provisions also target inverted companies specifically. Under the model treaty provision, important treaty benefits (e.g., benefits of reduced US withholding rates on interest, dividends, royalties and 'other income') are unavailable to US companies completing inversion transactions for a period of ten years after the inversion. This would apply even for payments made to unrelated persons. So, for example, if a US company were to complete an inversion transaction (becoming a subsidiary of a foreign company), it would not be able to benefit from reduced withholding rates under treaties for ten years after the inversion. This could raise borrowing costs for such US companies, because the universe of lenders that could lend to them on a withholding-free basis would be much smaller than that which currently exists. (Almost all banks in treaty jurisdictions would either choose not to lend or would demand a gross-up.)

Finally, the treaty provisions also take aim squarely at earnings stripping. Even if the LOB provisions were satisfied, treaty benefits would be denied for interest, dividends and similar payments paid to a related party where the payments benefit from a 'special tax regime' in the jurisdiction of the recipient of the payment. This would prevent the erosion of the US tax base through deductible payments without a significant amount of offsetting tax in the treaty jurisdiction. Even this proposal, however, takes aim at more than just inverted companies; by denying benefits even for non-inverted groups, it would likely discourage even cash takeovers of US companies by foreign companies.

iv Conclusion

This much is clear: the inversion frenzy has abated since last year. But we are far from reaching a new point of stability in the US international tax system. The IRS and Treasury will doubtless continue to use all tools at their disposal to preserve the United States' interest in taxing worldwide income of its corporations, including 'trapped cash' in foreign subsidiaries. And US corporations will continue to exploit the existing rules to their advantage. If history is any guide, this high-stakes cat-and-mouse game will continue, probably for many years, until lawmakers in the legislative and executive branches can craft a solution that attracts the necessary political support to create new laws.

IX COMPETITION LAW

In the past year the Antitrust Division of the Department of Justice (DoJ) and the Federal Trade Commission (FTC, and together with the DoJ, 'the agencies') have continued to carefully examine potential anti-competitive effects of all types of transactions involving a wide variety of industries, and have litigated a number of high-profile merger challenges in federal court at the trial and appellate levels.[153] The FTC has focused in particular on the health-care sector, devoting significant resources over the last year to investigate health-care mergers, and, in a number of such cases, has required remedies or pursued enforcement actions, recently obtaining two favourable rulings from federal appellate courts on such challenges.[154] The agencies have also made clear that they continue to take seriously and are willing to prosecute parties for illegal premerger coordination, commonly referred to as 'gun-jumping'.[155] In 2014, the FTC brought 18 merger actions in Second Request or compulsory process investigations,[156] and the DoJ challenged,

153 See Deborah L. Feinstein, Bureau of Competition, Director's Report (Spring 2015), https://www.ftc.gov/system/files/documents/public_statements/637441/bc_directors_report_-_spring_2015.pdf.

154 Id.

155 See Press Release, Dept. of Justice, 'Justice Department Reaches $5 Million Settlement with Flakeboard, Arauco, Inversiones Angelini and Sierrapine for Illegal Premerger Coordination', 7 November 2014, www.justice.gov/atr/public/press_releases/2014/309786.htm.

156 See Fed. Trade Comm'n Fiscal Year 2014 Summary of Performance and Financial Information, https://www.ftc.gov/system/files/documents/reports/ftc-fy-2014-summar

restructured or saw the abandonment of 20 proposed transactions.[157] In 2014 through the first half of 2015, the FTC challenged 28 mergers; in most of those cases, the challenge was resolved through a negotiated remedy, allowing the merger to proceed, but in three cases the transaction was abandoned following the FTC's challenge, and in three other cases, the FTC acted to block the merger, including in *Sysco/US Foods*, which is currently being litigated in federal district court.[158]

In February 2015, the FTC increased the filing thresholds under the HSR Act. Under the new thresholds, the 'size of transaction' test will be satisfied for most transactions valued over $76.3 million (increased from $75.9 million).[159] Moreover, in March 2015, the FTC adopted revisions to its Rules of Practice. Most notably under the revised rules, the FTC will now automatically suspend administrative litigation, upon the merging parties' request, if the FTC loses a motion for a preliminary injunction in the matter in federal district court, so as to allow the FTC to determine on a case-by-case basis whether it would be in the public interest to continue pursuing the administrative litigation.[160] In terms of personnel changes since the prior edition, Francine Lafontaine was named director of the FTC's Bureau of Economics, and Alexis Gilman was promoted to Assistant Director of the Mergers IV Division.[161]

i Department of Justice

The DoJ reviewed a variety of high-profile transactions over the last year, several of which resulted in the parties abandoning the transaction after the DoJ expressed competitive concerns.

y-performance-financial-information/150218fy14spfi.pdf.

157 See Division Update Spring 2015, Civil Program Update, www.justice.gov/atr/division-update/2015/civil-program-update.

158 See Press Release, Fed. Trade Comm'n, 'FTC Chairwoman Ramirez Testifies Before House Judiciary Subcommittee on Antitrust Enforcement and Priorities to Promote Competition and Protect Consumers', 15 May 2015, https://www.ftc.gov/news-events/press-releases/2015/05/ftc-chairwoman-ramirez-testifies-house-judiciary-subcommittee.

159 See Press Release, Fed. Trade Comm'n, 'FTC Announces New Thresholds for Clayton Act Antitrust Reviews for 2015', 15 January 2015, https://www.ftc.gov/news-events/press-releases/2015/01/ftc-announces-new-thresholds-clayton-act-antitrust-reviews-2015.

160 See Press Release, Fed. Trade Comm'n, 'Commission Approves Revisions to its Rules of Practice', 13 March 2015, https://www.ftc.gov/news-events/press-releases/2015/03/commission-approves-revisions-its-rules-practice.

161 See Press Release, Fed. Trade Comm'n, 'Francine Lafontaine Named Director of FTC's Bureau of Economics', 29 September 2014, https://www.ftc.gov/news-events/press-releases/2014/09/francine-lafontaine-named-director-ftcs-bureau-economics; Press Release, Fed. Trade Comm'n, 'Keeper league, Antitrust-Style', 2 September 2014, https://www.ftc.gov/news-events/blogs/competition-matters/2014/09/keeper-league-antitrust-style.

Comcast/Time Warner Cable

On 13 February 2014, Time Warner Cable Inc (TWC) and Comcast Corp (Comcast) announced an agreement for TWC to be acquired by Comcast in a deal valued at $45 billion.[162] At the time, the companies publicly predicted that the deal would win regulatory approval because they did not have cable subscribers in overlapping geographic regions, a prediction with which many analysts agreed both because of the lack of subscriber overlap and the proven strength of Comcast's lobbying abilities, which helped it overcome regulatory hurdles to win approval of its acquisition of a majority stake in NBCUniversal in 2011.[163] As one analysis observed, in light of these dynamics, the deal 'felt to many like a sure thing' and had an 'air of inevitability' hanging over it.[164] Comcast also offered to shed over 3 million subscribers to keep its share of the cable market below 30 per cent.[165]

In mid-April 2014, over 14 months after the deal was announced, Comcast and TWC had their first face-to-face meeting with the DoJ to discuss possible concessions that would satisfy any competitive concerns.[166] But whereas Comcast and TWC argued that the deal would not reduce consumer choice for cable services, both the DoJ and the Federal Communications Commission (FCC), with whom the DoJ was coordinating to review the transaction, were focused more on the effects of the deal in the market for broadband internet.[167] Both agencies reportedly had expressed concerns that the combined company would have significant market power in the broadband Internet market and an advantage over competitors offering online video programming, and the DoJ was reviewing whether Comcast violated an agreement, made as a condition to its acquisition of NBCUniversal, to relinquish its management rights in Hulu, the online streaming service controlled by NCBUniversal.[168] Specifically, the DoJ was investigating whether Comcast took an active role in the proposed sale of Hulu by its co-owners, 21st

162 See Cecilia Kang, 'Comcast, Time Warner Agree to Merge in $45 Billion Deal', *Washington Post*, 13 February 2014, www.washingtonpost.com/business/economy/comcast-time-warner-agree-to-merge-in-45-billion-deal/2014/02/13/7b778d60-9469-11e3-84e1-27626c5ef5fb_story.html.

163 Id.

164 See Jonathan Mahler, 'Once Comcast's Deal Shifted to a Focus on Broadband, Its Ambitions Were Sunk', *New York Times*, 23 April 2015, www.nytimes.com/2015/04/24/business/media/once-comcasts-deal-shifted-to-a-focus-on-broadband-its-ambitions-were-sunk.html?action=click&contentCollection=Media&module=RelatedCoverage&region=Marginalia&pgtype=article.

165 Kang, 'Comcast, Time Warner Agree to Merge', *supra* note 162.

166 See Shalina Ramachandran, Joe Flint & Brent Kindall, 'Comcast Strives to Save Merger With Time Warner Cable', *Wall Street Journal,* 19 April 2015, www.wsj.com/articles/comcast-and-time-warner-cable-to-meet-with-doj-to-negotiate-merger-1429410969.

167 Id.

168 Id.; see also Press Release, Dept. of Justice, 'Justice Department Allows Comcast-NBCU Joint Venture to Proceed With Conditions', 18 January 2011, www.justice.gov/atr/public/press_releases/2011/266149.htm.

Century Fox Inc and Walt Disney Co, by playing a role in the parties ultimately deciding not to sell the service.[169] With the DoJ's focus on potential effects of the transaction in the broadband market, the fact that the companies lacked subscriber overlap in the cable market no longer ensured a straight path to approval. Commentator also noted a political dynamic at play: the Obama administration had come out in support of 'net neutrality' – the principle that internet providers should treat all internet traffic equally – and '[a]t the end of the day, the government's commitment to maintaining a free and open Internet did not square with the prospect of a single company controlling as much as 40 per cent of the public's access to it'.[170]

On 24 April 2015, just days after the companies' meetings with federal regulators, Comcast announced that it was abandoning the deal as a result of regulatory pressure.[171] According to reports, the FCC told the companies that it was prepared to submit the case to an administrative law judge, which would likely have resulted in significant delays, and Attorney General Eric Holder reportedly had authorised the DoJ attorneys reviewing the deal to challenge it.[172] In announcing Comcast's abandonment of the deal, Attorney General Holder confirmed that the DoJ had 'informed the companies that it had significant concerns that the merger would make Comcast an unavoidable gatekeeper for Internet-based services that rely on a broadband connection to reach consumers', and that, in DoJ's view, '[t]he companies' decision to abandon the deal is the best outcome for American consumers'.[173]

Flakeboard/SierraPine

On 1 October 2014, Flakeboard American Ltd (Flakeboard) abandoned its plan to acquire three mills from SierraPine after the DoJ expressed concerns about the transaction's likely competitive effects in the market for medium-density fibreboard (MDF), a manufactured wood product used in furniture, kitchen cabinets and decorative mouldings.[174] According

169 See Ramachandran, Flint & Kindall, 'Comcast Strives to Save Merger With Time Warner Cable', *supra* note 166.

170 See Mahler, 'Once Comcast's Deal Shifted to a Focus on Broadband', *supra* note 164.

171 See Press Release, Dept. of Justice, 'Comcast Corporation Abandons Proposed Acquisition of Time Warner Cable After Justice Department and the Federal Communications Commission Informed Parties of Concerns', 24 April 2015, www.justice.gov/opa/pr/comcast-corporation-abandons-proposed-acquisition-time-warner-cable-after-justice-department.

172 See Emily Steel, 'Under Regulators' Scrutiny, Comcast and Time Warner Cable End Deal', *New York Times*, 24 April 2015, www.nytimes.com/2015/04/25/business/media/comcast-time-warner-cable-deal.html?action=click&contentCollection=Media&module=RelatedCoverage&region=Marginalia&pgtype=article.

173 See Press Release, Dept. of Justice, 'Comcast Corporation Abandons Proposed Acquisition of Time Warner Cable After Justice Department and the Federal Communications Commission Informed Parties of Concerns', 24 April 2015, www.justice.gov/opa/pr/comcast-corporation-abandons-proposed-acquisition-time-warner-cable-after-justice-department.

174 See Press Release, Dept. of Justice, 'Flakeboard Abandons Its Proposed Acquisition of SierraPine', 1 October 2014, www.justice.gov/atr/public/press_releases/2014/309005.htm.

to the DoJ, Flakeboard and SierraPine are two of only four significant suppliers of MDF to the West Coast and are the two closest sellers for many MDF customers.[175] The DoJ analysed effects in a market for 'thicker and denser grades of MDF' sold on the West Coast and claimed that, post-transaction, Flakeboard would have a 58 per cent share of that market.[176] The DoJ found both unilateral and coordinated effects likely – by eliminating the head-to-head competition between the companies on the West Coast, the DoJ claimed, Flakeboard would have a greater ability to increase prices as well as coordinate with its few remaining rivals.[177]

The case is particularly notable for what happened after Flakeboard abandoned the proposed transaction. On 7 November 2014, the DoJ announced that it had filed in federal district court and, the same day, settled a complaint alleging that the companies violated the HSR Act and Section 1 of the Sherman Act through unlawful pre-merger coordination.[178] According to the complaint, after announcing the proposed acquisition in January 2014, and before the expiration of the waiting period under the HSR Act, Flakeboard and SierraPine illegally coordinated to close one of the three mills included in the deal, and move the mill's customers to Flakeboard, leading to the permanent shutdown of the SierraPine mill and enabling Flakeboard to secure a significant number of the mill's former customers – in short, the parties prematurely transferred to Flakeboard operational control, and therefore beneficial ownership, of the SierraPine mill before the DoJ concluded its review of the proposed transaction, thus violating the HSR Act.[179]

Each party in a transaction is subject to a maximum civil penalty of $16,000 per day for each day the party is in violation of the HSR Act.[180] In this case, the proposed settlement required the companies to pay a combined $3.8 million in civil penalties, less than the maximum applicable penalty, and establish antitrust compliance programs; Flakeboard also was required to disgorge $1.15 million in profits.[181] In announcing the settlement, the DoJ noted that it had decided to reduce the maximum penalty in light of the fact that the companies voluntarily provided DoJ with evidence of their unlawful conduct.[182] Even with that reduction, however, the settlement resulted in the second-largest civil penalty for pre-merger coordination in DoJ history.[183]

175 Id.

176 Id.

177 Id.

178 See Press Release, Dept. of Justice, 'Justice Department Reaches $5 Million Settlement With Flakeboard, Arauco, Inversiones Angelini and SierraPine for Illegal Premerger Coordination', 7 November 2014, www.justice.gov/atr/public/press_releases/2014/309786.htm.

179 Id.

180 Id.

181 Id.

182 Id.

183 See Division Update Spring 2015, Civil Program Update, www.justice.gov/atr/division-update/2015/civil-program-update.

ii Federal Trade Commission

In 2014, the FTC continued to demonstrate its willingness to challenge transactions that it believes are likely to reduce competition and increase prices, whether in local geographic markets or in national markets, or both. This past year saw the FTC challenge a number of high-profile transactions involving a wide range of industries, including its attempt to block the proposed merger between Sysco Corporation (Sysco) and US Foods Inc (US Foods), which is still being litigated in federal district court, and several cases involving healthcare mergers, including two cases in which the FTC received favourable rulings from a court of appeals.

Sysco/US Food

On 19 February 2015, over a year after it initiated its investigation of the deal, the FTC filed an administrative complaint to prevent the proposed merger of Sysco and USF Holding Corp and US Foods, Inc, the two largest broadline foodservice distribution services in the United States.[184] The administrative complaint alleges that the merger would significantly reduce competition nationwide and in 32 local markets for broadline foodservice distribution services, causing entities such as restaurants, hospitals, hotels and schools to face higher prices and diminished customer service.[185] Broadline foodservice distributors provide extensive product lines for their foodservice customers, including both national brands and private-label products. Sysco and US Foods' strong national presence also allow them to provide frequent delivery to their customers, as well as various high-level customer services such as order tracking and menu planning. According to the FTC, the proposed merger would eliminate the pervasive head-to-head competition between the two 'best and most often used' broadline distributors in both national and local markets.[186] Combined, Sysco and US Foods account for 75 per cent of the national market for these distribution services.[187] The FTC alleged that the parties' agreement violated Section 5 of the FTC Act and that the merger would, if completed, violate Section 7 of the Clayton Act. The complaint highlighted the distinct services that broadline distributors provide, which allow their customers to have consistency in pricing, service, ordering and products.[188] According to the FTC, these services are not easily substituted by other forms of foodservice distribution such as specialty distributors, which carry only limited product lines, or cash-and-carry stores, which do not deliver.[189]

Prior to the filing of the complaint, US Foods proposed a divestiture package whereby it would divest 11 distribution centers to rival Performance Food Group,

184 Press Release, Fed. Trade Comm'n, 'FTC Challenges Proposed Merger of Sysco and US Foods', 19 February 2015, https://www.ftc.gov/news-events/press-releases/2015/02/ftc-challenges-proposed-merger-sysco-us-foods.

185 Id.

186 See Complaint at 4, 17, *In the Matter of Sysco/USF Holding/US Foods*, No. 9364 (FTC 19 February. 2015).

187 See id. at 3.

188 Id. at 2.

189 See id. at 8.

the industry's next-largest company after US Foods and Sysco, with 5 per cent of the national market.[190] According to the FTC, however, the plan would not 'restore the competition lost by eliminating US Foods as an independent competitor', and would thus not remedy the competitive harm of the merger.[191]

On 20 February 2015, the FTC filed a complaint in federal court in the district of Columbia, seeking a temporary restraining order and preliminary injunction to prevent the proposed merger pending the outcome of the administrative proceeding.[192] The complaint was filed jointly with the state Attorneys General of California, Illinois, Iowa, Maryland, Minnesota, Nebraska, Ohio, Pennsylvania, Tennessee, Virginia and the district of Columbia. The defendants stipulated on 27 February 2015 that they would not consummate the proposed merger until the court rules on the FTC's motion.[193] An evidentiary hearing was held on 5 May 2015, and continued to 14 May 2015. The evidentiary hearing underscored the importance to the FTC's case of customer reaction to the deal. The FTC relied heavily on complaints from customers of both Sysco and US Foods that the proposed merger would leave them with significantly less effective alternatives, as well as the risk that Sysco would have less incentive to maintain its high quality of customer service.[194] Ultimately, the FTC called five customers currently contracting with US Foods in either national or local markets as witnesses during the evidentiary hearing. Sysco and US Foods disputed the FTC's contention that the merger would reduce options and raise prices for foodservice customers, countering that this view of the relevant market ignored both the thousands of food distributors that compete for these businesses as well as the effect of the financial crisis on the growth of the foodservice industry.[195] Commentators have noted that the key deciding factor in the federal court's ruling will be how it interprets the food distribution marketplace, and whether broadline distributors like Sysco and US Foods are indeed distinct from specialty distributors or other types of wholesale food suppliers.[196] Oral argument on the preliminary injunction was held on 28 May 2015. The court has yet to rule on the FTC's motion.

190 Id. at 5.

191 Id.

192 See Complaint for Temporary Restraining Order and Preliminary Injunction at 1-2, *FTC v. Sysco Corporation*, No. 15-cv-00256 (APM) (D.D.C. 20 February 2015).

193 See Stipulation and Order, *FTC v. Sysco Corporation*, No. 15-cv-00256 (APM) (D.D.C. 27 February 2015).

194 See Complaint for Temporary Restraining Order and Preliminary Injunction at 8, *FTC v. Sysco Corporation,* No. 15-cv-00256 (APM) (D.D.C. 20 February 2015).

195 See Brett Kendall, 'US Foods Will Kill Sysco Deal if Court Delays Merger, Executive Says', *Wall Street Journal*, 11 May 2015, www.wsj.com/articles/top-sysco-executive-defends-us-foods-deal-in-court-testimony-1431369386.

196 See, e.g., Brett Kendall, 'Sysco-US Foods Merger Hinges on Judge's Interpretation of Marketplace', *Wall Street Journal*, 5 May 2015, www.wsj.com/articles/sysco-us-foods-merger-hinges-on-judges-interpretation-of-marketplace-1430852128.

St. Luke's/Saltzer

As discussed in the prior edition, on 12 March 2013, the FTC and the Idaho Attorney General jointly filed a complaint in federal district court seeking a permanent injunction to unwind St. Luke's Health System Ltd (St. Luke's) acquisition of Saltzer Medical Group, PA (Saltzer), Idaho's largest independent, multi-specialty physician practice group.[197] St. Luke's had acquired the assets of Saltzer on 31 December 2012, in a non-HSR reportable transaction.[198] The *St. Luke's* case went to trial in late 2013, and on 24 January 2014, the federal district court ruled in favour of the FTC, holding that the acquisition violated Section 7 of the Clayton Act and the Idaho Competition Act.[199] The court found that the substantial post-acquisition market share of St. Luke's would give it a dominant bargaining position over health plans and that it was highly likely that St. Luke's would use that market power to receive increased reimbursements, which would result in higher premiums and deductibles for consumers.[200] St. Luke's was ordered to fully divest all Saltzer physicians and assets and 'take any further action needed to unwind the acquisition'.

On 10 February 2015, the Ninth Circuit affirmed the district court's ruling.[201] As the FTC noted in its press release regarding the affirmance, the Ninth Circuit's decision offers 'many lessons…about the interpretation and application of Section 7' of the Clayton Act,[202] particularly with respect to the availability and scope of the so-called 'post-merger efficiencies defense'. On appeal, St. Luke's rebuttal of the FTC's *prima facie* case focused on the contention that the merger would allow it to move toward integrated care and risk-based reimbursement, resulting in higher quality, lower cost health care for consumers. Addressing this argument, the Ninth Circuit noted that other circuits have 'suggested that proof of post-merger efficiencies could rebut a Clayton Act Section

197 Press Release, Fed. Trade Comm'n, 'FTC and Idaho Attorney General Challenge St. Luke's Health System's Acquisition of Saltzer Medical Group as Anticompetitive', 12 March 2013, www.ftc.gov/news-events/press-releases/2013/03/ftc-and-idaho-attorney-general-challenge-st-lukes-health-systems.

198 See Complaint for Permanent Injunction at 8, *FTC and State of Idaho v. St. Luke's Health System, Ltd and Saltzer Medical Group, P.A.*, No. 13-cv-116-BLW (D. Idaho 26 March 2013).

199 Press Release, Fed. Trade Comm'n, 'Statement of FTC Chairwoman Edith Ramirez on the U.S. District Court in the District of Idaho Ruling in the Matter of the Federal Trade Commission and the State of Idaho v. St. Luke's Health System Ltd. and Saltzer Medical Group, P.A.', 24 January 2014, www.ftc.gov/news-events/press-releases/2014/01/statement-ftc-chairwoman-edith-ramirez-us-district-court-district.

200 See Findings of Fact and Conclusions of Law at 27, *FTC and State of Idaho v. St. Luke's Health System, Ltd. and Saltzer Medical Group, P.A.*, No. 1:13-cv-00116-BLW (D. Idaho 24 January 2014).

201 See *St. Alphonsus Med. Center-Nampa Inc. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775 (9th Cir. 2015).

202 See Press Release, Fed. Trade Comm'n, '9th Circuit Affirms: St Luke's/Saltzer Merger Violates Section 7', 10 February 2015, https://www.ftc.gov/news-events/blogs/competition-matters/2015/02/9th-circuit-affirms-st-lukessaltzer-merger-violates.

7 *prima facie* case' and that the FTC had 'cautiously recognized the defense', but no appellate decision had held that a Section 7 defendant's efficiency defence rebutted a *prima facie* case of anti-competitive effects, and 'the parameters of the defense remain imprecise'.[203] Although expressing scepticism about the defence in general and its scope in particular, the court ultimately held that the defense is available, but 'the language of the Clayton Act must be [its] linchpin': 'a successful efficiencies defense requires proof that a merger is not, despite the existence of a *prima facie* case, anticompetitive' and must establish that the efficiencies are 'extraordinary' and 'merger specific', that is, they cannot 'readily be achieved without concomitant loss of a competitor'.[204] As the court made clear, this is a significant burden for a defendant seeking to rely on the defence, one that St. Luke's was unable to overcome only with evidence that the merger would allow it to improve the delivery of health care to patients in the relevant geographic market – 'a laudible goal', but not one, the court ruled, that excuses a merger that lessens competition or creates monopolies.[205]

ProMedica/St. Luke's

The FTC achieved another victory at the appellate level in connection with its challenge of the proposed merger between ProMedica Health System Inc (ProMedica) and St. Luke's Hospital.[206] In *ProMedica Health Sys., Inc v. FTC*,[207] the Sixth Circuit upheld the FTC's order to ProMedica, the largest hospital system in Luca County, Ohio, to divest St. Luke's Hospital, an independent community hospital in the area, because the merger would leave ProMedica with more than 50 per cent of the market for primary and secondary services and more than 80 per cent of the market for inpatient obstetrical services.[208] The deal was announced in May 2010, and shortly thereafter the FTC initiated its investigation and entered a 'hold separate agreement' with ProMedica that allowed the deal to close but prohibited ProMedica from terminating St. Luke's Hospital's contracts with managed care organisations (MCOs), eliminating or transferring its clinical services or terminating its employees without cause during the pendency of the FTC's review.[209] The FTC filed an administrative complaint in January 2011, and later that month, along with the state of Ohio, filed a separate complaint in federal district court seeking a preliminary injunction that would extend the hold separate agreement pending the outcome of the administrative proceedings, which the district court granted in March 2011.[210] Later that year, the administrative law judge (ALJ) presiding over the FTC's administrative complaint found that the merger would substantially increase

203 St. Alphonsus, 778 F.3d at 789.

204 Id. at 790-91 (internal quotations and citations omitted).

205 Id. at 791-92.

206 See *Promedica Health Sys., Inc. v. FTC*, 749 F.3d 559 (6th Cir. 2014).

207 749 F.3d 559 (6th Cir. 2014).

208 Id. at 562.

209 Id. at 564.

210 Id.; see also Press Release, Fed. Trade Comm'n, 'Statement by FTC Bureau of Competition Director Richard Feinstein on the Court Ruling Granting a Preliminary Injunction in the

industry concentration, increase ProMedica's bargaining power with MCOs and allow ProMedica to increase prices above competitive levels.[211] The Commission affirmed the ALJ's decision, and the appeal to the Sixth Circuit followed.

Explaining the competitive dynamics in the relevant markets, the Sixth Circuit noted that MCOs, the direct purchasers of health-care services, 'must offer a comprehensive range of services – primary, secondary, tertiary, and quaternary – within a geographic range that patients are willing to travel for each of those services', which 'in turn create[s] leverage for hospitals to raise rates: to the extent patients view a hospital's service as desirable or even essential', for example, because of its location or its reputation, 'the hospital's bargaining power increases'.[212] In this case, the court noted, 'no MCO has offered a network that did not include either' of the merging parties, underscoring the importance of the head-to-head competition between them.[213] Moreover, the merger would result in market concentration levels that substantially exceeded the levels the agencies consider to be presumptively anticompetitive.[214] The Sixth Circuit rejected ProMedica's argument that concentration levels are not relevant in a case alleging potential harm through unilateral effects rather than coordinated effects, and held that the FTC was correct to presume the merger substantially anti-competitive in light of the post-merger concentration levels.[215]

Like the defendants in St. Alphonsus (regarding the St. Luke's merger with Saltzer described above), ProMedica also attempted to rebut the FTC's *prima facie* case; notably, however, rather than seek to demonstrate merger-specific efficiencies, ProMedica sought to rebut the FTC's case with a so-called 'flailing firm' or 'weakened competitors' defence – that is, the argument that 'St. Luke's was in such dire financial straits before the merger that it was not a meaningful competitive constraint on ProMedica'.[216] In rejecting this argument, the Sixth Circuit described it as 'the Hail-Mary pass of presumptively doomed mergers', one credited by courts 'only in rare cases' where the acquiring firm makes a substantial showing that, absent the merger, the acquired firm's market share would reduce to a level that would undermine the FTC's *prima facie* case'.[217] Although St. Luke's Hospital's pre-merger struggles were to some extent supported by the record, the court concluded that they 'provide no basis to' rebut the FTC's findings about the merger's anti-competitive effects.[218] *ProMedica* is also another example where the FTC's case was bolstered by internal party documents. For example, the court noted St. Luke's Hospital's board presentations indicating that 'a merger with ProMedica had the greatest potential

ProMedica/St. Luke's Hospital Matter', 29 March 2011, https://www.ftc.gov/news-events/press-releases/2011/03/statement-ftc-bureau-competition-director-richard-feinstein-court.

211 778 F.3d at 564.

212 Id.

213 Id.

214 Id. at 568.

215 Id. at 569-570.

216 Id. at 572.

217 Id. at 572.

218 Id.

for higher hospital rates' and would give the combined entity 'a lot of negotiating clout' over MCOs.[219] These documents along with the testimony of the parties' executives led the Sixth Circuit to observe that 'the Commission's best witnesses were the merging parties themselves'.[220]

The defendants in *ProMedica* filed a petition for Supreme Court review of the Sixth Circuit's decision, which the FTC has opposed. As the FTC has noted, if the defendants' petition is granted, it would be the first merger case before the Supreme Court on substantive grounds in over 40 years.[221]

X OUTLOOK

M&A rose close to pre-crisis levels in 2014, with mega-deals stealing the market and acquirers using inexpensive credit, increased corporate funds, finite private equity capital reserves and healthy equity markets. It seems that confidence was back and actors in large sectors such as power and energy, health care and media and entertainment have showed they have no intention of limiting their reach for more activity and bigger companies. However, the government is taking notice of large deals, whether for antitrust, tax, financial regulation or national security concerns and the start of 2015 has already suggested that M&A activity, measured by dollar volume, will slow as a result, even if M&A volume by number of deals increases. Regulation has affected the viability of certain deals and has raised concerns about the regulatory environment to come.

219 Id. at 563 (internal citations omitted).

220 Id. at 571.

221 See Deborah L. Feinstein, Bureau of Competition, Director's Report (Spring 2015), https://www.ftc.gov/system/files/documents/public_statements/637441/bc_directors_report_-_spring_2015.pdf.

JENNER & BLOCK

DEAN N. PANOS, Partner

Dean N. Panos is a litigator. Fortune 500 companies and other public and private companies seek his representation in a wide variety of complex commercial litigation in state and federal courts across the United States. He has served as lead trial counsel on numerous jury and bench trials and argued several cases before the United States Court of Appeals for the Seventh Circuit. Mr. Panos is nationally recognized in representing several of the largest food and beverage and consumer product manufacturers in class action and complex commercial litigation. He has also served as lead on several consumer and food product recalls. Mr. Panos has also served as trial counsel to a major airline in connection with two commercial aviation accidents.

Mr. Panos has represented numerous large manufacturers and private equity firms in claims for breach of fiduciary duty, breach of contract, fraud and misrepresentation in connection with corporate mergers and acquisitions. Corporate Boards of Directors and Audit Committees have also sought his counsel on a variety of internal investigations involving financial and accounting fraud, mismanagement and employee wrongdoing. Mr. Panos frequently represents clients in criminal grand jury investigations, as well as corporations and executives in SEC investigations or claims. He has served as Acting Inspector General for governmental and other public agencies conducting investigations into vendor and employee fraud.

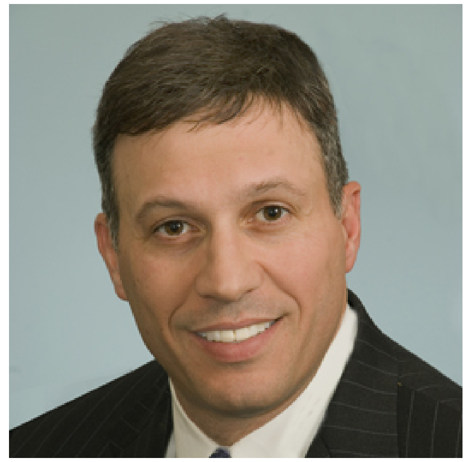
Mr. Panos is AV Peer Review Rated, Martindale-Hubbell's highest peer recognition for ethical standards and legal ability. He is the Chair of the Products Liability and Mass Tort Defense Practice and a member of the Complex Commercial Litigation, Class Action, and Real Estate and Construction Litigation Practices. He is also a member of the firm's Policy Committee and the Real Estate Finance Litigation and Workout Task Force. Mr. Panos has tried to verdict several felony cases for pro bono clients.

Awards

- *Chambers USA*
  Food & Beverages: Regulatory & Litigation (Nationwide) - 2014, 2015
- The BTI Consulting Group's 2013 "Client Service All-Star List"

Community Involvement

- Chicagoland Chamber of Commerce
  Board of Directors
- Constitutional Rights Foundation



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PRACTICE GROUPS

Class Action
Complex Commercial Litigation
Consumer Law
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Products Liability
Real Estate and Construction Litigation

EDUCATION

Valparaiso University School of Law, J.D., 1990; High Distinction, Senior Honors

Miami University at Oxford, B.S., 1987; Dean's List

ADMISSIONS

Illinois, 1990

Indiana, 1990

COURT ADMISSIONS

U.S. Supreme Court, 2006

U.S. Court of Appeals, Ninth Circuit, 2009

U.S. Court of Appeals, Sixth Circuit, 2005

U.S. Court of Appeals, Seventh Circuit, 1992

U.S. District Court, Eastern District of Michigan, 2001

U.S. District Court, Northern District of Illinois, 1990

U.S. District Court, Northern District of Indiana, 1990

U.S. District Court, Southern District of Indiana, 1990

Publications

- Co-Author, "Recent Developments in Product Recalls," *Product Liability Litigation: Current Law, Strategies and Best Practices*, Practising Law Institute, 2009
- "Crimes and Misdemeanors," *Food Processing Magazine*, September 2002
- *Insurance Counselor*, Summer 2002
- "After the Recall," *Food Processing Magazine*, August 2002
- "A Model for Food Manufacturers in Crisis," *Food Processing Magazine*, Spring 2002
- "The Law Relating to Product Recalls," *Food Processing Magazine*, Winter 2002
- "The Players in Foodborne Illness Recalls," *Food Processing Magazine*, Fall 2001
- "A Course of Action for Food Processors Facing Recalls," *Food Processing Magazine*, Summer 2001
- "Making the Recall Decision," *Food Processing Magazine*, Spring 2001

Speaking Engagements

- Panelist, "Recent Food Litigation Trends: What's Healthy, What's Natural, and Who Says So?" UCLA School of Law, April 11, 2014

James J. Savina,
Senior Vice President, Global General Counsel and Corporate Secretary
The Kraft Heinz Company

Biography

James Savina was appointed Senior Vice President, Global General Counsel and Corporate Secretary upon the closing of the 2015 Merger. Mr. Savina served as Kraft's Senior Vice President, Deputy General Counsel and Chief Compliance Officer from March 2015 to July 2015, and Vice President, Associate General Counsel and Chief Compliance Officer from February 2013 to March 2015. Prior to joining Kraft in 2013, he served as Executive Director, Global Legal Investigations and Operations of Avon Products, Inc., a global manufacturer of beauty and related products, since April 2010.

Jonathan J. Katz

Partner, Executive Compensation and Benefits

Jonathan Katz is a partner in Cravath's Executive Compensation and Benefits Department. His practice focuses primarily on advising clients on the executive compensation and employee benefit aspects of complex mergers and acquisitions, spin-offs, corporate joint ventures and private equity transactions. Mr. Katz also regularly advises clients on the design, negotiation and implementation of employment agreements and incentive compensation programs.

Mr. Katz's clients have included 3G Capital, The Kraft Heinz Company, Mylan, Starwood Hotels, Cameron International, Johnson & Johnson, Time Warner, IBM, NCR, BDT Capital Partners, Ashland, Cincinnati Bell and Alere.

Mr. Katz's recent transactions include representing:

- H.J. Heinz Company in its $60 billion merger with Kraft Foods Group to create The Kraft Heinz Company;

- Mylan in its pending $9.9 billion offer for Meda, its proposal to acquire Perrigo in a transaction valued at approximately $35 billion and its $5.6 billion inversion acquisition of Abbott Laboratories' non-U.S. developed markets specialty and branded generics business;

- Alere in its pending $8 billion sale to Abbott Laboratories;

- Starwood Hotels in its pending $12 billion sale to Marriott International;

- Cameron International in its pending $15 billion sale to Schlumberger and in the creation of the OneSubsea joint venture with Schlumberger;

- Johnson & Johnson in its acquisition of Novira Therapeutics;

- Time Warner in the spin-offs of Time Inc. and Time Warner Cable;

- UTi Worldwide in its $1.35 billion sale to DSV;

- NCR in its strategic partnership with Blackstone, including an $820 million equity investment in NCR by Blackstone;

- Jones Group in its $2.2 billion sale to Sycamore Partners;

- Grupo Villar Mir and its subsidiary Grupo FerroAtlántica in its combination with Globe Specialty Metals;

- The Cutrale Group and the Safra Group in their $1.3 billion acquisition of Chiquita, which followed a successful proxy solicitation by Cutrale-Safra against the Chiquita-Fyffes business combination transaction entered into in March 2014;
- BDT Capital Partners in connection with the ERISA aspects of structuring BDT Capital Partners Fund II and its related parallel funds and the $5.2 billion fundraising of capital commitments from over 100 investors;
- Ashland in its $3.2 billion acquisition of International Specialty Products;
- Cincinnati Bell its $525 million acquisition of CyrusOne;
- IBM in numerous transactions, including the acquisitions of Kenexa, Tealeaf, Worklight and Cúram; and
- Universal Health Services in its $500 million acquisition of Ascend Health.

Mr. Katz was born in Philadelphia, Pennsylvania. He received a B.S. from Cornell University in 2003, a J.D. *summa cum laude* from Cardozo School of Law in 2007, where he was Notes Editor of the Law Review, and an LL.M. from New York University School of Law in 2013. He joined Cravath in 2007 and became a partner in 2016.

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Gary Jay Kushner has been a food industry lawyer for more than 35 years. He represents trade associations and corporations before government agencies, Congressional committees, and the courts in a variety of matters. Gary has particular experience with the development, interpretation, and enforcement of laws and regulations governing food production, processing, and distribution throughout the United States and internationally. He also serves as general counsel to a number of national associations.

As counsel to trade associations and companies involved in the public policy arena, Gary analyzes legislation introduced in Congress and state legislatures, as well as regulations proposed by the U.S. Department of Agriculture, the Food and Drug Administration, and other federal and state government agencies. He routinely evaluates their impact on the food industry from farm to table, and prepares amendments, testimony, and comments on such initiatives. He anticipates how laws and regulations might be changed to facilitate the marketing of food products.

Gary also represents food companies including manufacturers, distributors, and retailers in matters involving regulatory compliance. He advises them on labeling and advertising regulation; counsels them in product recalls, seizures, detention, government inspections, and related actions; and represents them in enforcement actions before government agencies and law enforcement bodies.

Before joining Hogan & Hartson, Gary served as Vice President and General Counsel for the American Meat Institute where he directed the organization's legal, regulatory, and legislative activities. Before first entering the private practice of law, he served as Staff Counsel for Scientific Affairs at the Grocery Manufacturers of America. He began his legal career as a law clerk to The Honorable John R. Hess in the Superior Court for the District of Columbia.

Gary is a frequent lecturer and regularly contributes to numerous trade publications. He co-authored a chapter on new enforcement authorities in *The Food Safety Modernization Act: A Comprehensive Practical Guide to the Landmark Legislation*, prepared for the Food and Drug Law Institute, Washington, D.C. 2012. He is also co-author of A *Guide to Federal Food Labeling Requirements*, prepared for the U.S. Department of Agriculture and the U.S. Department of Health and Human Services, Government Printing Office, Washington, D.C., 1990; *HACCP Management Manual: A Guide to Food Regulatory Compliance*, published by Food Chemical News, Washington, D.C., 1996; and *Summary of Law on Warranties and Disclaimers in the Sale of Seed*, published by the American Seed Trade Association, Washington, D.C., 1996.

BRIAN M. JORGENSEN

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Brian Jorgensen represents corporate clients in complex labor and employment litigation, including class action and multiplaintiff employment discrimination lawsuits, wage and hour class and collective actions, and trade secrets and restrictive covenant matters. His experience includes defending employers in arbitrations, government agency proceedings, and state and federal courts throughout the United States in cases involving federal and state antidiscrimination laws, the Fair Labor Standards Act, state wage and hour laws, and a variety of state law wrongful discharge, statutory, contract, and tort claims. Brian also represents clients who are undergoing OFCCP audits and regularly provides advice regarding compliance with affirmative action laws.

In addition, Brian spends considerable time working with clients on preventative measures, including reviewing employment policies, advising on compliance with wage and hour laws, counseling on disciplinary actions and investigations, and conducting employment practices reviews.

Brian leads the Labor & Employment Practice in the Dallas office. He is a frequent speaker and author on labor and employment topics. He also serves on the board of Healing Hands Ministries and is a member of the Labor & Employment sections of the Texas State Bar Association and the Dallas Bar Association.

EXPERIENCE HIGHLIGHTS

Bridgestone attempts $947 million all-cash tender offer for Pep Boys
Jones Day represented Bridgestone Americas, Inc. in its proposed acquisition, through its wholly owned subsidiary Bridgestone Retail Operations, LLC ("BSRO"), of The Pep Boys - Manny, Moe & Jack, in an all-cash tender offer of $947 million.

Verizon Wireless defeats class certification in Store Managers misclassification class actions
On April 14, 2015, Judge Johnson, of the California Superior Court for the County of Los Angeles, agreed with Jones Day client AirTouch Cellular dba Verizon Wireless ("AirTouch") that class certification is inappropriate in two wage and hour misclassification class actions.

Dex Media successfully defeats application for TRO in "inevitable disclosure" and trade secret misappropriation lawsuit filed by competitor
Jones Day successfully defeated an application for a temporary restraining order for its client Dex Media, Inc. ("Dex Media") in a trade secret misappropriation and breach of contract case filed by hibu, Inc., a competitor of Dex Media.

U.S. Steel wins Supreme Court donning and doffing case
On January 27, 2014, the U.S. Supreme Court unanimously upheld the Seventh Circuit Court of Appeals' decision in favor of Jones Day client U.S. Steel Corporation when it ruled that the time workers spent donning and doffing work clothes was not compensable.

Major hospital system renegotiates strategic relationship with academic institution
Jones Day advised a major hospital system on the renegotiation of a strategic relationship with an academic institution, including corporate governance counseling on potential duties and potential litigation impact.

AirTouch Cellular decision affirmed by California Court of Appeals
Jones Day represented AirTouch Cellular, doing business as Verizon Wireless, in a wage and hour class action in which the plaintiff alleges that the company did not provide required meal and rest breaks for its California retail store employees, did not reimburse its California employees for all business-related mileage expenses, and did not reimburse its California employees for expenses associated with the business use of

their concession phones.

Court Square Capital completes sale of Mosaic Sales Solutions to Acosta

Jones Day advised Court Square Capital Partners in connection with its sale of Mosaic Sales Solutions, a provider of merchandising, direct and assisted selling, product knowledge transfer, and experiential marketing services, to Acosta, Inc., a portfolio company of Thomas H. Lee Partners.

Verizon Wireless successfully defeats class certification in California wage and hour class action

Jones Day represented Verizon Wireless in a wage and hour class action in which the plaintiff alleges that the Company did not provide required meal and rest breaks for its California retail store employees, did not reimburse its California employees for all business-related mileage expenses, and did not reimburse its California employees for expenses associated with the business use of their concession phones.

Verizon Wireless obtains summary judgment in California wage and hour class action

Jones Day represented AirTouch Cellular d/b/a Verizon Wireless in a putative class action alleging that it violates California's labor laws by taking chargebacks from the commissions paid to its retail sales employees.

Verizon Wireless defeats class certification in California wage and hour case

Jones Day represented AirTouch Cellular d/b/a Verizon Wireless in a putative class action alleging that it violates California's split-shift and reporting time pay laws by paying its retail employees only for actual time spent at mandatory meetings.

St. Jude Neuromodulation Division defeats claim by competitor that new hire violated non-compete

Jones Day represented Advanced Neuromodulation Systems in an action brought by a competitor seeking to enforce a non-compete agreement against an employee hired by ANS.

U.S. Steel prevails in "donning & doffing" FLSA case filed by United Steelworkers local union

Jones Day provided defense to U.S. Steel Corporation in a collective action in which plaintiffs seek to represent all non-exempt production and maintenance employees at Clairton Works and claim that U. S. Steel has failed to pay them overtime compensation for time spent donning and doffing protective clothing and traveling to and from their worksites.

U.S. Steel wins summary judgment in putative nationwide FLSA collective action of "donning & doffing"

Jones Day defended United States Steel Corporation in a putative nationwide collective action in which plaintiffs seek to represent all non-exempt production and maintenance employees at U.S. Steel's facilities.

Morton's successfully defends against nationwide class action in which claimants allege they were paid less than minimum wage due to alleged improper tip credits

Jones Day represented Morton's Restaurant Group, Inc. in a nationwide class action where claimants alleged that Morton's tip credit practices violated the Fair Labor Standards Act ("FLSA").

Morton's obtains settlement in FLSA class action

Jones Day represented Morton's Restaurant Group, Inc. in a class action, covering over 300 servers at Morton's New York locations.

Morton's negotiates settlement in FLSA wage and hour class action

Jones Day represented Morton's Restaurant Group, Inc. in a consolidated action involving 78 claimants.

Idearc Media defends multi-state class and collective action, in which the plaintiffs allege violations of state and federal law for alleged off-the-clock work

Jones Day is currently representing Idearc Media Corp. in a multi-state class and collective action, in which the plaintiffs claimed that they are entitled to straight time and overtime wages under state and federal law for alleged off-the-clock work.

Idearc Media defends statewide class action in California, in which plaintiffs claimed that their incentive payments were improperly reduced

Jones Day represented Idearc Media Corp. in a statewide class action in California where the plaintiffs claimed that their incentive payments were improperly reduced.

Verizon Wireless defends electronic donning and doffing case involving call center workers

Jones Day is currently representing Verizon Wireless, Inc. in a putative statewide class action where the Plaintiff claims violations of the FLSA and New York state law for alleged pre- and post-shift off-the-clock work.

St. Jude Neuromodulation Division obtains injunctive relief against competitor and former employees

Jones Day represented Advanced Neuromodulation Systems in an action alleging that two former employees violated agreements with ANS and improperly retained confidential information.

HONORS & DISTINCTIONS

Best Lawyers in America (2016)

Texas Super Lawyers (2014-2015)

Texas Super Lawyers "Rising Star" (2012-2013)

Law360 — "Rising Star Under 40," labor and employment (2012) (one of five in the U.S.)

Recommended by *D Magazine* as one of the "Best Lawyers in Dallas" (2013-2016)

EDUCATION

Texas Tech University (J.D. magna cum laude 1999; Order of the Coif; Phi Kappa Phi; Managing Editor, Law Review); University of Missouri-Columbia (B.J. 1996)

BAR ADMISSIONS

Texas; U.S. District Courts for the Northern, Southern, Eastern, and Western Districts of Texas; and U.S. Court of Appeal for the Tenth Circuit

PUBLICATIONS

January 2016
Department of Labor Attempts to Take Broad View of Joint Employment Status

May 2015
Mach Mining, LLC v. EEOC: Supreme Court Holds that Courts May Engage in Limited Review of EEOC Conciliation Efforts

May 2015
What Oil and Gas Companies Can Do to Mitigate Unpaid Wage Claims, *Energy Litigation Journal*, Vol. 14 No. 3

December 2014
Integrity Staffing Solutions v. Busk: Supreme Court Rules Time Spent at Security Checkpoint Not Compensable

November 10, 2014
Drilling Down: Wage and Hour Claims, *Texas Lawyer*

October 20, 2014
Wage & Hour Update: Recent Trends in Wage and Hour Litigation and Enforcement

September 2014
"Ban the Box": A Discussion of State and Local Laws Restricting Inquiries into an Applicant's Criminal History

December 2013
Fifth Circuit Holds that NLRB Erred in Finding that Arbitration Agreements with Class Action Waivers Violate NLRA

October 2013
Expanding Compliance Obligations: What Federal Contractors Need to Know About OFCCP's New Disability and Veterans Regulations

August 2013
Court Enters Judgment Against EEOC in Criminal Background Check Case

June 2013
U.S. Supreme Court Imposes High Standard on Title VII Retaliation Plaintiffs

June 2013
U.S. Supreme Court Clarifies Who Is a Supervisor Under Title VII

June 2013
Texas Enacts Uniform Trade Secrets Act

March 2013
OFCCP Rescinds 2006 Compensation Standards and Self-Audit Guidelines and Replaces Them With Directive Calling for Expansive Investigations

December 2012
EEOC Sets Its Priorities in Strategic Enforcement Plan

December 2012
Employee breaches fiduciary duty to employer when employee solicits customers or co-workers while still employed, *Practitioner Insights, WestlawNext*

November 2012
When to WARN? WARN Act Notice Amid the Threat of Sequestration

April 2012
OFCCP Rescinds Directive on Jurisdiction Over Health Care Providers

July 2011
Stock Options Now Valid Consideration for Noncompete Agreements in Texas

March 2011
Supreme Court Rules That FLSA's Anti-Retaliation Provision Covers Oral Complaints

March 2011
Labor & Employment Alert: OFCCP Issues Active Case Enforcement Directive

April 2010
Preparing for Increased Wage and Hour Litigation and DOL Enforcement: A Primer for Texas Employers

April 5, 2010
Take Steps Now to Comply With Genetic Antidiscrimination Law, Reprinted with permission from the April 5, 2010 issue of *Texas Lawyer* © 2010 ALM Media Properties (Read the article.)

March 16, 2010
Wage and Hour Compliance: Key Issues Affecting the Hospitality Industry

2009
Wage/Hour Jeopardy: The Regular Rate of Pay Under the Fair Labor Standards Act and Calculating Overtime for Non-Exempt Employees, *The American Bar Association Section of Labor and Employment Law National Conference on Equal Employment Law*

March 2007
Calculating Overtime for Non-Exempt Employees and the FLSA Regular Rate

November 2006
Texas Supreme Court Clarifies Confusion Over Enforcement of Noncompete Agreements for At-Will Employers

1997-1998

Delegations in Danger:, author, Texas Boll Weevil Eradication Foundation, Inc. v. Lewellen, 952 S.W.2d 454; 29 Tex. Tech L.Rev. 213

SPEAKING ENGAGEMENTS

February 27, 2015
2015 Speaker Series: Drilling Down: Wage and Hour Claims in the Energy Industry
Pittsburgh, Pennsylvania

October 28, 2014
Expanding Federal Contractor Employment Obligations: President Obama's Recent Executive Orders and New OFCCP Requirements
Webinar

October 28, 2014
OFCCP Webinar
Washington, D.C., Webinar

October 20, 2014
Wage & Hour Update: Recent Trends in Wage and Hour Litigation and Enforcement, Dallas Bar Association, Labor & Employment Section
Dallas, Texas

October 16, 2013
Expanding Obligations: What Federal Contractors Need to Know About the OFCCP's New Policy Directions
Webinar

October 20, 2011
Jones Day Dallas CLE University
Dallas, Texas

October 20, 2011
Twitterpation: Social Media in the Workplace, Jones Day Dallas MCLE University
Dallas, Texas

August 15, 2011
Tax Implications and Practical Impacts of Damages in Employment Cases
Dallas, Texas

March 23, 2011
Fair Labor Standards Act in Texas: Compensable Time - Regular and Overtime
Dallas, Texas

October 20, 2010
Big Budgets and Aggressive Agendas: The Impact of Increased Regulation on Employers, Jones Day Dallas MCLE University
Dallas, Texas

October 2010
Jones Day MCLE University - Dallas
Dallas, Texas

October 15, 2010
CEO Netweavers, Navigating the Wage-Hour Maze in a Litigation Happy Environment
Dallas, Texas

March 16, 2010
Wage and Hour Compliance: Key Issues Affecting the Hospitality Industry, 2010 Hospitality Labor & Employment Discussion Group
Chicago, Illinois

November 4, 2009
2009-2010 Federal Legislative and Regulatory Briefing
Dalllas, Texas

April 7. 2009
Law and Policy Review
Houston, Texas

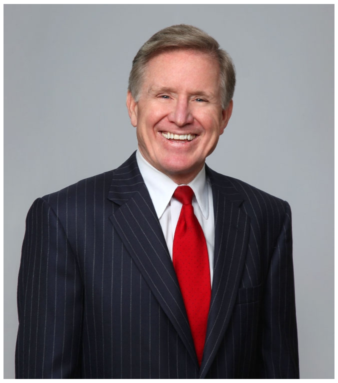
January 16, 2009
Negotiating the Jungle of Employment Law, Entrepreneurial Development Series, Legal Issues for the Entrepreneur
Dallas, Texas

August 26, 2008
Noncompetition Agreements and Trade Secret Protection in Today's Environment
Dallas, Texas

March 18, 2008
Employment Law Training
Plano, Texas

August 28, 2007
Employment Law Training
Louisville, Kentucky

SUTHERLAND



James M. Cain

Partner
Washington

P: 202.383.0180
E: james.cain@sutherland.com

Education

J.D., Georgetown University Law Center

A.B., University of Notre Dame

Bar Admissions

California

District of Columbia

Nevada

Background

With more than three decades of experience, Jamie Cain has guided insurers, banks, securities and commodities firms, and funds through significant transactions that transform their businesses including public and private securities offerings and mergers and acquisitions. He regularly works with U.S. and foreign companies to interpret and comply with the myriad of securities, commodities, insurance and banking laws that apply to these transactions.

A frequent speaker at industry conferences, Jamie is recognized for his knowledge of the Dodd-Frank Act and the regulation and use of derivatives including those instruments used for interest rate, foreign exchange, equity and commodity, credit default and equity transactions and related collateral arrangements. He represents a wide range of global clients, typically on the buy side, including major public companies, financial institutions, public and private funds, government sponsored enterprises, and foreign governments, in documenting those transactions and advising on internal and regulatory compliance.

Jamie also advises insurers, banks and broker-dealers in connection with cross-industry acquisitions and in the distribution of their respective products both domestically and internationally.

Experience

- Sutherland advises public companies on OTC derivatives transactions and Dodd-Frank Act compliance.
- Sutherland counsels life insurers and GSEs on swap transaction documentation.
- Sutherland represents a series of energy, metal and agricultural ETFs.
- Sutherland represents ETF in a multiagency trading practices investigation.
- Sutherland advises annuity insurers on drafting Dodd-Frank Act comment letters.
- Sutherland represents major commercial energy firms in Dodd-Frank Act implementation and compliance.
- Sutherland counsels U.S. insurer on creating an offshore segregated accounts company.

- Sutherland advises clients on various OTC transactions.
- Sutherland advises foreign government on OTC derivatives.
- Sutherland advises GSEs on OTC interest rate transactions.
- Sutherland counsels foreign insurer on regulatory and compliance matters.
- Sutherland advises on acquisition of insurance product wholesaler.
- Sutherland counsels insurers on third-party marketing.
- Sutherland advises bank on equity investments and on regulatory compliance.
- Sutherland advises bank on insurance premium financing regulations.
- Sutherland counsels wire house on insurance product structure, distribution.
- Sutherland provides advice to GSE on multi-billion dollar debt programs.
- Sutherland represents agricultural cooperative in connection sale through auctions of subsidiaries.
- Sutherland assists oil and gas company with development of ISDA documentation and policies, negotiates ISDA agreements for company.
- Sutherland represents actively managed ETF investing in cleared CDS.
- Sutherland advises public company in connection with CFTC inquiry.
- Sutherland advises public companies in connection with CFTC inquiry and other matters.

Awards

- Named to *The Best Lawyers in America* in the area of derivatives and futures law **(2006-2016)**

Professional Activities

- Member, Banking Law Committee and Derivatives and Futures Law Committee, Business Law Section, American Bar Association
- Member, Law and Compliance Division, Futures Industry Association
- Member, Various ISDA Committees
- Member, MFA

Articles

- Preparing for the Squall: The Coming Margin Requirements for OTC Derivatives (April 2015)
  The Review of Banking & Financial Services

- Putting the CFTC's 'Swap' Definition into Context (June 5, 2014)
  Law360

- The CPO and CTA Regulatory Regimes: What Operators of and Advisers to Commodity Pools Should Expect in 2013 (May 2013)
  Futures & Derivatives Law Report

- Regulatory watch list for 2012: the shifting landscape for hedge funds and other private funds (June 2012)
  Journal of Investment Compliance

- Defining ‘Swap Dealer’ and ‘Major Swap Participant’ (April 24, 2012)

- Regulatory Watch List for 2012: Commodity ETF Industry (February 16, 2012)
  Reprinted with permission from *Securities and Banking Law360*

- 2012 Regulatory Watch List: Commodity ETF Industry (February 16, 2012)
  Law360

- Dodd-Frank Necessitates New Legal Documentation for Cleared and Uncleared Swaps (July 13, 2011)
  The Review of Securities & Commodities Regulation

- Exchange-Traded Funds - Offering Transparency, Liquidity and Diversification in Turbulent Markets (July 15, 2009)
  Reprinted with permission from *The Review of Securities & Commodities Regulation*

- Financial Institution Insurance Activities - A New 2001 Odyssey Begins (May 2002)
  Business Lawyer, Volume 57, Number 3

- Financial Institution Insurance Activities - Gramm-Leach-Bliley One Year Later (May 2001)
  Business Lawyer, Volume 56, Number 3

- Banks and Insurance Companies - Together in the New Millennium (May 2000)
  Business Lawyer, Volume 55, Number 3

- Financial Institution Insurance Activities––Courts and Regulators Continue to Dominate Congress (May 1999)
  Business Lawyer, Volume 54, Number 3

- Functional Regulation of Bank Sales of Insurance––A Complicated Matrix is Developing with Potential Pitfalls (May 1998)
  Business Lawyer, Volume 53, Number 3

- Bank Sales of Annuities and Insurance Products (June 18, 1997)
  The Review of Banking & Financial Services, Volume 13, Number 3

- Financial Institutions and Insurance in 1996: Three Strikes, You’re Out? (May 1997)
  Business Lawyer, Volume 52, Number 3

- Financial Institutions and Insurance in 1995: State Insurance Regulators Assert Authority Over Banks (May 1996)
  Business Lawyer, Volume 51, Number 3

- Financial Institutions and Insurance in 1994: VALIC becomes NationsBank (May 1995)
  Business Lawyer, Volume 50, Number 3

- Financial Institutions and Insurance in 1993: The Climate Becomes Uncertain (May 1994)
  Business Lawyer, Volume 49, Number 3

- Financial Institutions in 1992: A Year of Retrenchment (May 1993)
  Business Lawyer, Volume 48, Number 3

Presentations

- Alternative Investments: Current Regulatory, SEC and IRS Developments (April 23, 2014)

- Credit Implications of Dodd-Frank (April 13, 2014)
  NPECA Annual Conference

- Derivatives Regulatory Reform (October 10, 2013)
  ACIC Annual Meeting and Educational Conference

- Credit Implications of Dodd-Frank (September 12, 2013)
  North American Power Credit Organization Meeting

- Hot Topics in Derivatives Under Dodd-Frank for Private Investment Funds (April 16, 2013)

- 7 Areas Commodity Pool Operators Should Watch In 2013 (January 29, 2013)
  Law360

- Dodd-Frank Act – One Year Later (September 2012)
  12th Annual LICONY Annual Legislative & Regulatory Conference

- Implementing Dodd-Frank: OTC Documentation Workshop (September 13, 2012)
  FIA Conference

- ISDA August 2012 Dodd-Frank Protocol (August 22, 2012)
  Insurers Working Group

- Futures Customer Account Agreements (July 12, 2012)
  MFA Seminar on Swaps Clearing Documentation

- Are You a Swap Dealer? Determining Swap Dealer Status and Related Implications (July 11, 2012)
  FIA Dodd-Frank Briefing for Energy & Ag Companies

- Association of Life Insurance Counsel Annual Meeting (May 22, 2012)
  Association of Life Insurance Counsel

- Sutherland Private Fund Advisers Team Quick Call - CFTC Recently Adopted Amendments to Regulations (April 17, 2012)
  Sutherland Quick Call

- New CFTC Rules Affecting Funds that Invest in Commodity Interests: How Will They Affect You? (March 15, 2012)
  Sutherland Quick Call

- Roundtable: Hot Topic in Investments (March 2, 2012)
  Wealth Management/HIMCO Law and Compliance Law Day, Hartford, Connecticut

- Top 10 for 2012: 10 Pending Developments All Wealth Management/ Compliance Lawyers Should Be Watching (March 2, 2012)
  Wealth Management/HIMCO Law and Compliance Law Day

- Dodd-Frank Implementation (October 17, 2011)
  2011 ACLI Annual Conference

- 2011 Argus U.S. Oil Market Regulation Summit (September 27, 2011)
  Argus U.S. Oil Market Regulation Summit

- The Dodd-Frank Bill: What Happened? (October 21, 2010 - October 22, 2010)
  American College of Investment Counsel 2010 Annual Meeting & Education Conference

- Impact of Title VII of Dodd-Frank on Insurance Companies and Their Affiliates (September 10, 2010)
  Sutherland Hartford Life Webinar

- Impact of Financial Regulatory Reform on the Insurance Industry: The Dodd-Frank Bill Arrives (July 27, 2010 - July 28, 2010)
  LIMRA's Broker-Dealer CEO and Strategic Issues Study Group

- Central Clearing of Interest Rate Swaps (June 15, 2010)
  Webinar

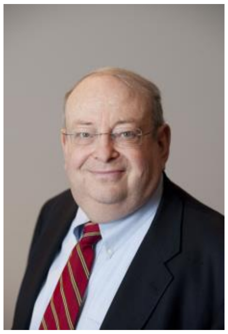
- Derivatives for Dummies: A Primer on OTC Co-Products (November 9, 2009)
  Corporation, Finance and Securities Section, Derivatives, Securitization and Project Finance Standing Committee, District of Columbia Bar

- Proposed Regulation for the OTC Derivatives Market (November 5, 2009 - November 6, 2009)
  National Rural Electric Cooperatives Association's (NRECA) 2009 G&T Legal Seminar

- Sutherland Securities Symposium (April 21, 2009)

Clerkships

- Honorable Edward C. Reed of the U.S. District Court



Jack Friedman
President
Directors Roundtable Institute

Jack Friedman is an executive and attorney active in diverse business and financial matters. He has appeared on ABC, CBS, NBC, CNN and PBS; and authored business articles in the Wall Street Journal, Barron's and the New York Times. He has served as an adjunct faculty member of Finance at Columbia University, NYU, UC (Berkeley) and UCLA. Mr. Friedman received his MBA in Finance and Economics from the Harvard Business School and a J.D. from the UCLA School of Law.