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National Competition Laws Bulletin

Mergers in China : An overview of leading case law

Foreword, Mergers, China

Note from the Editors: although the e-Competitions editors are doing their best to build a comprehensive set of the leading EU and national antitrust cases, the completeness of the database cannot be guaranteed. The present foreword seeks to provide readers with a view of the existing trends based primarily on cases reported in e-Competitions. Readers are welcome to bring any other relevant cases to the attention of the editors.

George S. Cary, Cunzhen Huang, Yiming Sun | e-Competitions | N°81533, www.concurrences.com

2016 marks the eighth year of the implementation of China's Anti-Monopoly Law ("AML"), which entrusted the Ministry of Commerce ("MOFCOM") in China with the authority to conduct merger control review. Having passed decisions on approximately 1,500 transactions, MOFCOM has quickly established itself as one of the most important competition authorities for global transactions.

As Table 1 below shows, MOFCOM has handled an increasing number of transactions over the past few years. During this time, the percentage of conditionally approved and prohibited transactions has declined.

Table 1: Yearly Breakdown of MOFCOM Decisions

-	Total Decisions	Unconditional approval	Conditional approval	Conditional approval %	Prohibited	Prohibited %
2016 Q1 & Q2	174	174	0 [1]	0%	0	0%
2015	312	310	2	0,6%	0	0%

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2014	245	240	4	1,6%	1	0,4%
2013	215	211	4	1,9%	0	0%
2008 - 2012 [2]	534	517	6	3%	1	0,2%

In this short article, we will discuss what we consider to be the major trends with regard to MOFCOM's merger control practice.

Trend 1: More Clarity on Notification Obligations

In May 2009, MOFCOM published the Guiding Opinions on Notification of Concentrations of Business Operators (the "Guiding Opinions") to codify when companies must notify the agency of a proposed concentration. Unfortunately, these rules did not address all the questions and concerns of the business community. Because MOFCOM published only a limited number of decisions in its early years of AML enforcement, companies remained uncertain as to whether particular transactions should be notified in China. The situation has improved marginally with the publication of the revised Guiding Opinions on June 6, 2014 [3], particularly as to under what circumstances a transaction conveys "control," a concept introduced earlier. The revised Guiding Opinions included MOFCOM's first explanation of the key concept of "control" in the AML. The revised Guiding Opinions also shed light on other important issues, including the assessment of newly-established joint ventures, the calculation of "China turnover," and the procedural details of pre-notification consultation meetings with MOFCOM. The revised Guiding Opinion has provided more clarity on the notification obligation.

Nonetheless, the revised Guiding Opinions have not addressed all issues related to the notification obligation. The revised Guiding Opinions did not elaborate on how much weight MOFCOM will give each factor used to determine control; nor do the limited number of published failure-to-file cases or conditional clearances provide further information about how MOFCOM weighs the listed factors in practice. In reality, businesses continue to be obligated to notify the regulator of non full-functional joint ventures with no local activity or other nexus with China, which do not give rise to any competition effect in China.

Trend 2: Streamlining the Merger Control Process

MOFCOM has been criticized for being the "bottleneck" in a number of global transactions. For example, in Xstrata/Glencore (2013), MOFCOM took 380 days to issue its conditional approval decision, five and nine months after the EU and the U.S. approved the transaction [4]. Before the 2014 introduction of the

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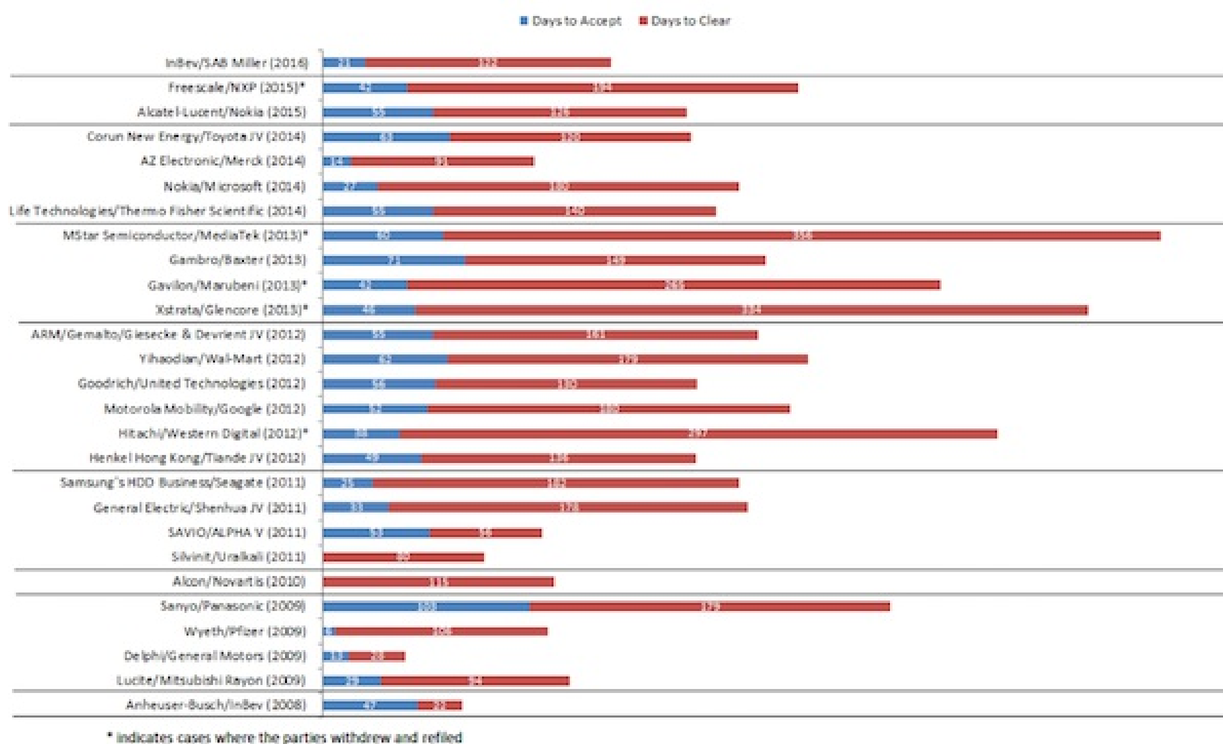
"simple case procedure," MOFCOM's review process could take months even for cases without any substantive competitive concerns, because the regulator used the same procedure employed in complex cases.

Table 2: Timeline of MOFCOM's Conditional Approval Decisions



In February 2014, MOFCOM introduced the "simple case procedure," designed to speed up the review of cases with no competition concerns. MOFCOM has published regulations and guidance on the criteria for qualifying for the simple case procedure and provided instructions on how to invoke the procedure.

In May 2014, MOFCOM published its decision in its first simple case—Rolls-Royce Holdings' proposed acquisition of the remaining interest in its joint venture with Daimler—which MOFCOM approved in 19 days. As of September 30, 2016, 2016, MOFCOM published notices on approximately 533 simple cases. MOFCOM is typically able to finish its review of a simple case by the end of the Phase I period [5]. Before the introduction of the simple case procedure, similar transactions would take as long as the Phase II period.

Table 3: Number of Approved Simple Cases

-	Total Unconditionally Approved Cases	Unconditionally Approved Simple Cases	Unconditionally Approved Normal Cases
May 14 2014 to June 30 2015	650	446	204

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MOFCOM's efforts to streamline its review process also include re-allocating the pre-acceptance review work from the Pre-Acceptance Consultation Division, which was tasked with reviewing the completeness of the filing before handing it over to a case team, to specific case teams. Cases will be allocated among three review divisions (including the previous Legal Division, the Economic Analysis Division, and the Consultation Division), that can now start reviewing the notification immediately after it is filed and manage the case to the end. This reorganization is intended to streamline the merger review process. We believe this reorganization is helpful also because it will result in review divisions with greater knowledge and understanding of the industries on which they focus, which will in turn speed up the merger review process.

MOFCOM does not publish how long an unconditional approval takes. It remains to be seen whether MOFCOM's re-organization efforts is achieving its major goal—shortening the review period.

Trend 3: Increased Transparency

In the first few years of its enforcement of AML, MOFCOM only published decisions of conditionally approved and prohibited transactions. It was therefore difficult to know whether and when MOFCOM was notified of a transaction or when it was cleared by the regulator. Vowing to increase the transparency of its work, MOFCOM has been publishing information of unconditionally approved cases on a quarterly basis since late 2012, including the parties' names, transaction type, and clearance date. Since the introduction of its simple case procedure, MOFCOM has published a concise description of each simple case for public comment once the case is accepted. Beginning in May 2014, MOFCOM began publishing penalty decisions in failure-to-file and noncompliance with remedies cases.

MOFCOM has sought to make its procedures and substantive standards more transparent by publishing more guidance and rules related to merger control, including, for example, Measures for the Undertaking Concentration Examination [6] and Provisions on Imposing Restrictive Conditions on the Concentration of Undertakings (for Trial Implementation) [7].

Despite the measures taken to improve transparency, MOFCOM remains reluctant to shed light on its stakeholder consultation process, which is an important and probably the most unpredictable and opaque part of MOFCOM's review. With no or very limited information from MOFCOM on third parties' identities and comments, filing parties often find it difficult, if not impossible, to address their concerns. The lack of access to such information hinders transparency, disrupts the filing parties' right to be heard, and prolongs MOFCOM's decision making process.

Trend 4: Non-Competition Factors Considered in Competition Assessment

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The legal basis for MOFCOM to consider non-competition factors is rooted in the AML, which explicitly provides that one of the purposes of the AML is to safeguard the public interest and promote the development of the socialist market economy. [**8**] MOFCOM is also mandated to consider any effect on the "national economic development" in its merger review [**9**]. Therefore, it is not surprising that non-competition factors have played a role in a number of high-profile transactions. Below we set out several non-competition factors that might have influenced MOFCOM's decisions in certain transactions.

Acquisition of local brands by a foreign company. In 2009, MOFCOM prohibited Coca-Cola's proposed acquisition of Huiyuan, a Chinese company with a leading national juice brand [**10**]. The decision was very brief and did not quantify the parties' market shares in the relevant markets. This decision was widely criticized and MOFCOM has attempted to rebut the accusation that it would prohibit acquisition of a well-known local brand by foreign companies. Since then, the regulator unconditionally approved several such transactions, including Yum! Brands' acquisition of Little Sheep Group in 2011, Nestle's acquisition of Xufuji in 2011, and Coca-Cola's acquisition of Culiangwang in 2015.

Transactions involving strategic industries, such as natural resources. MOFCOM's decisions in strategic industries have long been considered political. In Silvinit/Uralkali (2011) [**11**], where both parties are important suppliers of potash, MOFCOM required that the parties continue to supply Chinese customers with sufficient quantities to satisfy agricultural, industrial, and other demands. In Xstrata/Glencore (2013) [**12**], a horizontal merger where the combined share was less than 20%, in addition to a divestiture, MOFCOM required Glenore to continue supplying Chinese customers with copper, zinc, and lead concentrates on specified terms for eight years.

Foreign Investment Policy. In Yihaodian/Wal-Mart (2012), MOFCOM prohibited Wal-Mart from entering the telecommunications business through its control of Yihaodian, an online retailer also engaged in the value added telecommunications business. This requirement does not seem to address any specified competition concern but appears to underscore MOFCOM's authority over foreign investment policy.

We describe the above cases for purposes of illustration only. MOFCOM has never officially acknowledged the influence of non-competition factors in any of its cases. However, parties in global transactions should be aware of how non-competition factors may play a role when MOFCOM is reviewing their transactions and plan accordingly.

Trend 5: More Attention to Economic Analysis

MOFCOM agrees that economic analysis should play an important role in antitrust analysis. In its written submission to the OECD, MOFCOM stated that it "attaches great importance to economic analysis ideals and methods" in its enforcement and emphasized that it has an internal economic division that assists in

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merger review [13].

MOFCOM has also consulted with outside economists. According to its published decisions, MOFCOM has consulted third-party economic experts in at least seven decisions to date, including two prohibited transactions (Huiyuan/Coca-Cola (2009) and P3 Alliance (2014)) and five conditional approvals (Samsung's HDD Business/Seagate (2011), Hitachi/Western Digital (2012), MStar Semiconductor/MediaTek (2013), Life Technologies/Thermo Fisher Scientific (2014), and AZ Electronic/Merck (2014)). In Life Technologies/Thermo Fisher Scientific (2014), MOFCOM, for the first time, published its quantitative predictions of price increases based on economic modeling.

While MOFCOM has relied on economic analysis in some cases, it remains unclear how much weight MOFCOM has actually accorded economic analysis. MOFCOM has not always actively encouraged interaction between the companies' economists and MOFCOM's internal or external economists. We also note that some unconventional remedies imposed by MOFCOM, for example, hold-separate remedies, are difficult to justify with sound economic analysis.

Trend 6: Continued Unconventional Remedies

MOFCOM has shown greater willingness to impose behavioral remedies than the U.S. and the EU antitrust agencies: 22 out of 27 conditionally approved cases (including 11 horizontal mergers) involved behavioral remedies while 16 (including seven horizontal mergers) involved only behavioral remedies. By contrast, the antitrust authorities in Europe and the United States have a strong preference for structural remedies as the best way to remedy competition concerns resulting from horizontal overlaps: 88% of the remedies analyzed by the European Commission in its 2005 Merger Remedies Study were divestment remedies; in the United States, from 2010 to 2015, only 16 out of 133 transactions with remedies involved purely behavioral remedies, while all the others involved structural remedies.

Moreover, the behavioral remedies imposed by MOFCOM were often not tailored to address the specific competitive harm raised by the transaction. The Yihaodian/Wal-Mart (2012) decision, discussed above, imposed behavioral remedies that appeared to further MOFCOM's foreign investment policy without articulating a clear theory of harm. In Motorola Mobility/Google (2012), unlike other antitrust authorities, MOFCOM required behavioral remedies to address standard-essential patents concerns that were not merger specific. MOFCOM also used behavioral remedies in Thermo Fisher/Life, Glencore/Xstrata, and Uralkali/Silvinit to lock in favorable pricing and supply agreements for Chinese customers without a clear analysis of how such remedies addressed specific theories of competitive harm. In Thermo Fisher/Life, MOFCOM imposed behavioral remedies along with structural remedies, while the EU and U.S. regulators believed structural remedies to be sufficient.

Behavioral remedies have far-reaching consequences on the future commercial activities of the relevant

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companies and require constant supervision and periodic review to ensure effectiveness. For example, the four hold-separate remedies imposed by MOFCOM (MStar Semiconductor/MediaTek (2013), Gavilon/Marubeni (2013), Hitachi/Western Digital (2012), and Samsung's HDD Business/Seagate (2011)) significantly delayed the efficiency benefits from those transactions. MOFCOM has recently been asked to revisit the behavioral remedies that it previously imposed in several cases. In 2015, MOFCOM partially lifted the behavioral remedies imposed on Google for its acquisition of Motorola after the sale of Motorola to Lenovo, a Chinese technology company. Later that year, MOFCOM modified the conditions imposed in the Western Digital/Hitachi transaction and the Seagate/Samsung transaction.

More recently, in Freescale/NXP (2015), MOFCOM appeared to have aligned more closely with its EU and U.S. counterparts in imposing purely structural remedies. It remains to be seen whether MOFCOM will continue to impose unconventional behavioral remedies to secure the interests of Chinese stakeholders where China-specific concerns arise.

Trend 7: Stepping Up Penalty Enforcement

If a company fails to notify a transaction under the AML or violates its commitments, MOFCOM is empowered to impose monetary penalties up to RMB 500,000, to request that companies stop the transaction, or to take other measures to return the market to ex-ante state (including selling shares or assets or transferring businesses within a specified time period) [**14**]. In 2012, MOFCOM implemented the Interim Measures for Investigating and Handling Failure to Legally Declare the Concentration of Business Operators, [**15**] which explained how MOFCOM would carry out investigations of failures to file. In December 2014, MOFCOM published its first penalty decision for failure to file against Unigroup, which was fined RMB 300,000 for failing to notify its acquisition of RDA Microelectronics, a transaction valued at $907 million [**16**]. Through October 5, 2016, MOFCOM has issued eight fines, ranging from RMB 150,000 to RMB 400,000 each company, against both multinational (including Microsoft, Bombardier Transportation Sweden, and Hitachi) and domestic corporations for failure to file. One of the penalty decision was imposed for the acquisition of minority shareholding positions (35%). Four were imposed for the establishment of joint ventures. MOFCOM's first penalty decision on noncompliance with merger remedies was published in December 2014 against Western Digital for its alleged failure to fully comply with the "hold-separate" order imposed by MOFCOM in its Hitachi/Western Digital (2012) decision [**17**].

These published decisions signal toughened penalty enforcement by MOFCOM. While the fines have not been substantial and MOFCOM has not yet unwound a transaction, companies may still be concerned about associated reputational damage and possible delays in MOFCOM's review in future cases. More recently, MOFCOM is reported to be working to revise the AML to allow the agency to impose increased fines [**18**].

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Trend 8: Increased International Cooperation

MOFCOM has been active in expanding its international cooperation efforts. To date, MOFCOM has signed a Memorandum of Understanding (the "MoU") on Antitrust Cooperation with the antitrust authorities in the United States, European Union, Japan, Korea, Russia, Canada, South Africa, Australia, and Kenya.

MOFCOM has also maintained frequent contact with its counterparts in the United States, the European Union, and other jurisdictions on policy through international conferences and reciprocal visits.

MOFCOM has exchanged information with other antitrust authorities during actual case review. Requesting confidentiality waivers has become MOFCOM's standard practice in global transactions.

Over the past eight years since the AML has taken effect, MOFCOM has embraced its role as an antitrust authority in a rapidly-developing merger control regime and has become increasingly confident. Given the importance of MOFCOM in global merger control reviews, it is advisable to closely follow MOFCOM's enforcement trends, and especially those that diverge from international norms.

George S. Cary | Cleary Gottlieb Steen & Hamilton (Washington, DC) | gcary@cgsh.com
Cunzhen Huang | Cleary Gottlieb Steen & Hamilton (Washington, DC) | chuang@cgsh.com
Yiming Sun | Cleary Gottlieb Steen & Hamilton (Brussels) | yisun@cgsh.com

[1] MOFCOM published the InBev/SAB Miller conditional approval decision on July 29, 2016. As of October 5, 2016, MOFCOM has not published a list of unconditional approved transactions in 2016 Q3.

[2] MOFCOM did not systematically publish yearly breakdowns of its decisions prior to 2012.

[3] 《关于经营者集中申报的指导意见》, available at: http://fldj.mofcom.gov.cn/article/i/201406/20140600614679.shtml ↗. See **Michael Gu**, The Chinese MOFCOM releases the amended guiding opinions on notification of concentration of undertakings, 6 June 2014, e-Competitions Bulletin June 2014, Art. N° 67233

[4] See **Patrick Ma, John Tivey, Rebecca Campbell**, The Chinese MOFCOM clears merger in the mining industry (Glencore / Xstrata), 16 April 2013, e-Competitions Bulletin April 2013, Art. N° 51814 ; **Adrian Emch**, The Chinese MOFCOM conditionally clears a merger in the mining sector (Glencore / Xstrata), 16 April 2013, e-Competitions Bulletin April 2013, Art. N° 53373 ; **Susan Ning**, The Chinese MOFCOM clears conditionally an acquisition imposing both structural and behavioural remedies (Glencore / Xstrata), 16 April 2013, e-Competitions Bulletin April 2013, Art. N° 55167

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[5] According to the AML, there are two phases for MOFCOM's anti-trust review once a case was initiated. Phase I lasts for 30 days, and Phase II lasts for 90 days, with a possible extension of up to 60 days.

[6] 《经营者集中审查办法》, available at: http://fldj.mofcom.gov.cn/article/c/200911/20091106639145.shtml ↗ . See **Michael Gu**, The Chinese MOFCOM announces decision to publicize the decisions of administrative penalties of undertakings which did not submit a notification prior to the implementation of their concentration, 21 March 2014, e-Competitions Bulletin March 2014, Art. N° 67155

[7] 《关于经营者集中附加限制性条件的规定（试行）》, available at: http://www.mofcom.gov.cn/article/b/c/201412/20141200835207.shtml ↗ See **Susan Ning**, The Chinese MOFCOM publishes for public comment the draft Rules Regarding Imposition of Restrictive Conditions on Concentrations of Undertakings , 27 March 2013, e-Competitions Bulletin March 2013, Art. N° 55247

[8] Article 1 of the AML.

[9] Article 17 of the AML.

[10] See **Erik Söderlind, Yuan Cheng**, The Chinese MOFCOM halts acquisition of a leading Chinese juice producer by a foreign buyer (Coca-Cola/Huiyuan), 18 March 2009, e-Competitions Bulletin March 2009, Art. N° 41346 ; **Christopher Corr, Patrick Ma**, The Chinese MOFCOM blocks $2.4 billion acquisition of a leading Chinese juice producer by a foreign buyer (Coca-Cola / Huiyuan), 18 March 2009, e-Competitions Bulletin March 2009, Art. N° 36779 ; **James Lowe, Leon B. Greenfield, Jeffrey D. Ayer, Lester Ross**, The Chinese MOFCOM prohibits for the first time since the entry into effect of the new anti-monopoly law, a merger between a US soft drinks manufacturer and a Chinese juice producer (Coca-Cola / Huiyuan), 18 March 2009, e-Competitions Bulletin March 2009, Art. N° 36977

[11] See **Allan Fels, Xiaoye Wang, Jessica Su**, The Chinese MOFCOM conditionally clears merger between two Russian companies in the Chinese potash market (Uralkali/Silvinit), 2 June 2011, e-Competitions Bulletin June 2011, Art. N° 39091 ; **Peter J. Wang, Sébastien J. Evrard, Yizhe Zhang**, The Chinese MOFCOM approves merger between potash producers but requires they continue to supply the Chinese market (Silvinit and Uralkali), 2 June 2011, e-Competitions Bulletin June 2011, Art. N° 50110 ; **Susan Ning**, The Chinese MOFCOM conditionally clears in phase II a merger between two Russian companies in the Chinese potash market (Urakali / Silvinit), 2 June 2011, e-Competitions Bulletin June 2011, Art. N° 40973 ; **Yan Bai**, The Chinese MOFCOM clears with behavioral remedies a merger between Russian companies in the Chinese potash market (Uralkali/Silvinit), 2 June 2011, e-Competitions Bulletin June 2011, Art. N° 37136

[12] See **Patrick Ma, John Tivey, Rebecca Campbell**, The Chinese MOFCOM clears merger in the mining industry (Glencore / Xstrata), 16 April 2013, e-Competitions Bulletin April 2013, Art. N° 51814 ; **Adrian Emch**, The Chinese MOFCOM conditionally clears a merger in the mining sector (Glencore / Xstrata), 16 April 2013, e-Competitions Bulletin April 2013, Art. N° 53373 ; **Susan Ning**, The Chinese MOFCOM clears conditionally an acquisition imposing both structural and behavioural remedies (Glencore / Xstrata), 16 April 2013, e-Competitions Bulletin April 2013, Art. N° 55167

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[**13**] OECD, Economic Evidence in Merger Analysis, p. 265, available at http://www.oecd.org/daf/competition/EconomicEvidenceInMergerAnalysis2011.pdf ↗

[**14**] Article 48 of the AML.

[**15**] 《未依法申报经营者集中调查处理暂行办法》, available at http://www.mofcom.gov.cn/article/b/c/201201/20120107914884.shtml ↗ See **Yuan Cheng, Simon Poh, Robert Gavin, Jonas Koponen**, The Chinese MOFCOM issues new measures on investigating failures to notify concentrations, 5 janvier 2012, Bulletin e-Competitions January 2012, Art. N° 41758

[**16**] See **Michael Gu, Yu Shuitian**, The Chinese MOFCOM publishes penalty decisions regarding merger control for the first time (Unigroup / RDA Microelectronics ; Western Digital / Hitachi), 2 décembre 2014, Bulletin e-Competitions December 2014, Art. N° 70707

[**17**] See **Michael Gu, Yu Shuitian**, The Chinese MOFCOM publishes penalty decisions regarding merger control for the first time (Unigroup / RDA Microelectronics ; Western Digital / Hitachi), 2 décembre 2014, Bulletin e-Competitions December 2014, Art. N° 70707

[**18**] China regulators working on revising AML, to raise penalty for merger non-notification, available at http://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=784248&siteid=202&rdir=1 ↗.

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Too Many Gatekeepers? The Costs of Globalized Merger Control

George S. Cary

gcary@cgsh.com

Partner, Cleary Gottlieb Steen & Hamilton

Elaine Ewing

eewing@cgsh.com

Partner, Cleary Gottlieb Steen & Hamilton

Tara L. Tavernia

ttavernia@cgsh.com

Associate, Cleary Gottlieb Steen & Hamilton

Abstract

Over the last twenty years, an ever-growing number of jurisdictions have adopted merger control regimes. Although the global proliferation of merger control regimes has yielded some benefits, such as addressing competitive concerns in mergers with localized anticompetitive effects, it has also imposed substantial costs. These costs include, among others, at times significant delay in the ability to close a transaction and achieve anticipated efficiencies, the risk that an agency will improperly block a transaction or impose inefficient remedies, and the possibility that pro-competitive transactions will not be pursued in light of these concerns.

This article analyzes the costs and benefits of the global proliferation of merger control regimes and proposes steps that regulators can take to reduce the costs of globalized merger control without impairing their ability to address local competitive concerns.

One of the most striking changes in the antitrust world over the last two decades is the global proliferation of merger control regimes. Twenty years ago, companies seeking to merge could focus on the US agencies and the European Commission. Today, more than 100 countries have merger control regimes, with new jurisdictions joining the list each year. This expansion has yielded meaningful benefits—including the prevention of mergers with localized anticompetitive effects—but also has imposed significant costs that may well outweigh these benefits. Regulators and practitioners, however, can and should take steps to reduce these costs.

The global spread of merger control is widely heralded as a success. In a September 2015 speech, Margrethe Vestager, the European Commission's Commissioner for Competition, lauded the global proliferation of merger control as "good news . . . because many more people know that a competition watchdog will protect their interests if companies misbehave."[1] Certainly, there are many cases where the spread of merger control has protected consumers from local transactions generating local anticompetitive effects that might have gone unchecked 20 years earlier. For instance, in October 2015, Mexican authorities required that supermarket chain Soriana, in connection with its proposed merger with Comercial Mexicana, divest (or not acquire) grocery stores in 27 local markets in Mexico.[2] And in November 2015, Brazil's Council for Economic Defense ("CADE") conditionally cleared a transaction between two Brazilian dental products companies (Dabi Atlante and Gnatus), requiring divestiture of the Gnatus brand and the termination of exclusive distribution and service agreements.[3]

But, as we will discuss below, the global proliferation of merger control imposes real costs. In this respect, the global proliferation of merger control butts heads with another important trend of the last two decades—the shift away from the historical view that mergers are neutral at best and anticompetitive at worst. Today, there is widespread recognition that corporate transactions can have substantial pro-competitive benefits, including reductions in the marginal cost of production and the realization of research and development ("R&D") synergies. When the closing of a pro-competitive transaction is delayed while waiting for a dozen global clearances, so, of course, are its pro-competitive benefits.

In considering the costs of globalization, we draw a distinction between what we will term the "*internationalization*" of merger control and what we will term the "*globalization*" of merger control. The Soriana/Comercial Mexicana and Dabi Atlante/Gnatus cases exemplify internationalization—the phenomenon where the spread of global antitrust enforcement has allowed jurisdictions to prevent transactions that would otherwise cause local competitive harm.

"Globalization" is different. Globalization is the phenomenon whereby numerous agencies review the same global transaction and consider the same global effects. Rather than prevent anticompetitive transactions that would previously have proceeded unchecked, globalization layers additional bureaucracy, uncertainty, inefficiency, and costs onto transactions that were already being carefully reviewed and enforced, where appropriate. Rather than protect consumers, globalization effectively serves as a tax on major corporate transactions.

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1 Margrethe Vestager, Comm'r, Eur. Comm'n, *Merger review: Building a global community of practice*, Presented at the ICN Merger Workshop (Sept. 24, 2015), https://ec.europa.eu/commission/2014-2019/vestager/announcements/merger-review-building-global-community-practice_en.

2 Press Release, COFECE, Condiciona COFECE concentración entre Soriana y Comercial Mexicana (Oct. 9, 2015), https://www.cofece.mx/cofece/index.php/prensa/historico-de-noticias/condiciona-cofece-concentracion-entre-soriana-y-comercial-mexicana.

3 Press Release, CADE, Cade aprova fusão da Dabi Atlante e Gnatus (Nov. 25, 2015), http://www.cade.gov.br/Default.aspx?4bfe0f1aeb21f73bcf7dce61fd5f.

To be fair, there is a fine line between internationalization and globalization. A global transaction may involve local markets and jurisdictions with unique competitive dynamics and isolated problems. For example, in 2013, several jurisdictions conditionally cleared Nestlé's acquisition of Pfizer's nutrition business. Among others, South Africa[4] and Australia[5] required Nestlé to license Pfizer's infant formula products to another company in order to maintain existing local competitive dynamics. In late 2013 and early 2014, the purchase of the Slovenian food retail chain Mercator by Agrokor, a Croatian food production and retail group, was reviewed by several European countries and ultimately cleared, subject to conditions in Serbia[6] and Croatia[7] to address local competitive concerns. And in the Holcim/Lafarge transaction, CADE[8] and the Competition Commission of India[9] required the divestiture of certain local plants in order to remedy potential competitive harm in specific regional markets.

In thinking about the proliferation of merger control, then, the challenge becomes ensuring that the desire to catch these few cases does not impose an undue burden on the dozens or hundreds of global transactions that do not pose unique competitive harms in a handful of jurisdictions.

Finding the appropriate balance is difficult because of the "lowest common denominator" problem posed by merger control. In most contexts, even in antitrust, globalized enforcement means parallel regimes with effects specific to each jurisdiction. For example, the global spread of cartel enforcement largely involves jurisdictions individually assessing conduct and imposing penalties without any spillover effect in other jurisdictions. But in the merger review context, a decision made by any given jurisdiction has repercussions in every other country.

Before discussing the costs imposed, it may be instructive to review some data regarding the extent of global merger control.

Broadly, the global proliferation of merger control means that major international transactions may require filings in a dozen or more jurisdictions. While not a complete list, recent examples of transactions requiring 10 or more filings include: GSK/Novartis (21 jurisdictions); Lafarge/Holcim (20); Microsoft/Nokia (17); TRW Automotive/ZF Friedrichshafen (14); Nestlé/Pfizer Nutrition (13); Medtronic/Covidien (13); Lenovo/IBM (13); DuPont/Mitsui/DKK (13); Continental/Veyance (11); Eaton/Cooper (10); and Baxter/Gambro (10). Even smaller transactions may require half a dozen filings. Recent examples include Coca-Cola's sale of its energy drink business to Monster, which required six filings; 3M's acquisition of Capital Safety, which also required six filings; Onex's acquisition of Kraussmaffei's companies, which required seven filings; and Platform Specialty Products' acquisition of Alent, which required nine filings.

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4 Competition Trib. of S. Afr., Decision, Case No. 65/LM/Jun12 (015248) (Mar. 18, 2013), *available at* http://www.comptrib.co.za/assets/Uploads/65LMJun12-015248.pdf.

5 Press Release, Austl. Competition & Consumer Comm'n, ACCC to not oppose acquisition by Nestlé of Pfizer Nutrition (Nov. 22, 2012), https://www.accc.gov.au/media-release/accc-to-not-oppose-acquisition-by-nestl%C3%A9-of-pfizer-nutrition.

6 Comm'n for the Protection of Competition, Decision, No. 6/0-02-466/2013-199 (Dec. 25, 2013), *available at* http://www.kzk.org.rs/kzk/wp-content/uploads/2014/01/466-%D0%A5%D0%A5%D0%A5.pdf.

7 Press Release, Croatian Competition Agency, Agrokor-Mercator merger conditionally approved (Apr. 14, 2014), http://www.aztn.hr/en/agrokor-mercator-merger-conditionally-approved/.

8 Press Release, CADE, CADE approves with restrictions Holcim/Lafarge merger (Oct. 12, 2014), http://www.cade.gov.br/Default.aspx?81b445d42ce136fd0835065ffd44.

9 Competition Comm'n of India, Decision, No. C-2014/07/190 (Mar. 30, 2015), *available at*http://www.cci.gov.in/sites/default/files/C-2014-07-190_0.pdf.

Comparing the number of notifications filed in each jurisdiction reveals that certain jurisdictions are far more active than others. For example, in 2014, merging parties filed over 2,000 notifications in Russia,[10] around 1,000 notifications in Germany,[11] 781 notifications in the Ukraine,[12] 571 notifications in South Korea,[13] 423 notifications in Brazil,[14] 321 notifications in Austria,[15] 289 notifications in Japan,[16] 262 notifications in China,[17] 244 notifications in Canada,[18] 215 notifications in Turkey,[19] and 200 notifications in France.[20]

As you would expect, the number of filings reflects each jurisdiction's filing thresholds. Of the jurisdictions listed above, Ukraine offers an extreme example of low filing thresholds, requiring parties to file if their combined global assets or turnover exceeds €12 million, each party has at least €1 million in global assets or turnover, and at least one party has €1 million in Ukrainian assets or turnover.[21] While Germany requires the parties to have a combined global turnover of €500 million, the German-specific thresholds are quite low—one party must have €25 million in German turnover, and the second only needs to have €5 million in German turnover. Not surprisingly, these jurisdictions receive hundreds of filings per year. In contrast, France has rather high thresholds for French turnover, requiring each party to have at least €50 million in French turnover (in addition to €150 million in global turnover), and thus receives far fewer filings.

Notwithstanding these thousands of filings, the globalization of merger control has resulted in limited additional enforcement of global transactions. The instances where foreign-to-foreign transactions are subject to conditions or entirely blocked are few and far between. In France, 10 transactions were conditionally cleared in 2014, and none were foreign-to-foreign transactions.[22] In 2014, the German

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10 Alexander Viktorov, *Russia: Merger Control*, Getting the Deal Through (Sept. 8, 2015), https://gettingthedealthrough.com/area/20/jurisdiction/26/merger-control-russia/.

11 Evelyn Niitväli & Marc Reysen, *Germany: Merger Control*, Global Competition Rev. (n.d.), http://globalcompetitionreview.com/reviews/72/sections/249/chapters/2923/germany-merger-control/.

12 Sergey Denisenko & Denis Lysenko, *Ukraine: Merger Control*, Global Competition Rev. (n.d.), http://globalcompetitionreview.com/reviews/72/sections/270/chapters/2957/ukraine-merger-control/.

13 Sanghoon Shin & Seong-Un Yun, *Korea: Merger Control*, Getting the Deal Through (Sept. 8, 2015), https://gettingthedealthrough.com/area/20/jurisdiction/35/merger-control-korea/.

14 CADE, Balanço do triênio da Lei 12.529/11 (May 2015), http://www.cade.gov.br/upload/Balan%C3%A7o%203%20anos%20nova%20lei-atualizado.pdf.

15 Sarah Fürlinger & Theodor Thanner, *Austria: Federal Competition Authority*, Global Competition Rev. (n.d.), http://globalcompetitionreview.com/reviews/72/sections/240/chapters/2901/austria-federal-competition-authority/.

16 Akinori Uesugi & Kaori Yamada, *Japan: Merger Control*, Getting the Deal Through (Sept. 8, 2015), https://gettingthedealthrough.com/area/20/jurisdiction/36/merger-control-japan/ (reporting data for fiscal year 2014, which covers the period from April 1, 2014 through March 31, 2015).

17 Press Release, Ministry of Commerce of the People's Republic of China ("MOFCOM"), 2014 Business Review XVIIII: Carry out Anti-monopoly Work According to Law and Maintain a Market with Fair Competition (Feb. 5, 2015), http://english.mofcom.gov.cn/article/zt_businessreview/news/201503/20150300912159.shtml.

18 John Pecman, *Canada: Competition Bureau*, Global Competition Rev. (n.d.), http://globalcompetitionreview.com/reviews/74/sections/276/chapters/2992/canada-competition-bureau/.

19 Gönenç Gürkaynak & Ayşe Güner, *Turkey: Merger Control*, Global Competition Rev. (n.d.), http://globalcompetitionreview.com/reviews/72/sections/269/chapters/2956/turkey-merger-control/.

20 Bruno Lasserre, *France: Competition* Authority, Global Competition Rev. (n.d.), http://globalcompetitionreview.com/reviews/72/sections/248/chapters/2914/france-competition-authority/.

21 Ukraine also has a share threshold that requires filing where the combined entity will have a 35% or greater share in a relevant market.

22 Autorité de la Concurrence, *Le Contrôle des Concentrations*, http://www.autoritedelaconcurrence.fr/user/tableaudcc.php?dt=2014.

authority blocked one transaction[23] and granted conditional clearance to a second;[24] both of these transactions were domestic. In Turkey, no transactions were blocked in 2014, and of the three transactions that were cleared conditionally, only one was a foreign-to-foreign transaction, involving two European companies, Bekaert and Pirelli.[25] In Brazil, from 2012 to May 2015, 20 transactions were conditionally approved or blocked, and only five were foreign-to-foreign, all of which were conditionally approved.[26] In two of these five cases (Munksjö/Ahlstrom and Mach/Syniverse), the remedies imposed by CADE duplicated those imposed by European authorities. In Munksjö/Ahlstrom, Ahlstrom was required to divest a plant in Germany that the European Commission also required it to divest.[27] In Mach/Syniverse, Mach was required to divest assets related to certain services provided in Europe that the European Commission also required it sell.[28] In a third case, Continental/Veyance, CADE's remedy included the divestiture of a plant in Mexico that the US Department of Justice ("DOJ") also required the parties to divest.[29] Similarly, in Medtronic/Covidien, the Canadian consent decree requiring global divestiture of a pipeline product was near verbatim to the consent decree required by the US Federal Trade Commission ("FTC").[30]

China's antitrust authority in charge of reviewing mergers, MOFCOM, offers a stark contrast to those jurisdictions that focus on domestic transactions. Since 2008, MOFCOM has imposed remedies upon or blocked 28 transactions—23 of which were foreign-to-foreign.[31] Rather than focus on local effects, MOFCOM seems inclined to use the antitrust process to influence global industrial policy and to do so in furtherance of protectionist aims. In several cases, MOFCOM has imposed remedies on global transactions that exceeded the scope of any remedies imposed by other regulators, and has done so without a solid economic rationale. In Gavilon/Marubeni, Glencore/Xstrata,[32] ThermoFisher/Life, and Merck/AZ Electronic, MOFCOM imposed behavioral remedies related to pricing and supply in China that seem aimed at ensuring that Chinese customers receive products on particularly favorable terms. MOFCOM has also required merging parties to license their patents in China on favorable terms, including in Merck/AZ Electronic and Microsoft/Nokia—transactions that were unconditionally cleared by other global

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23 Fed. Cartel Office, Decision, B3-135/13 (May 14, 2014), *available at* http://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Entscheidungen/Fusionskontrolle/2014/B3-135-13.pdf?__blob=publicationFile&v=2.

24 Fed. Cartel Office, Decision, B6-98/13 (Apr. 25, 2014), *available at* http://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Entscheidungen/Fusionskontrolle/2014/B6-98-13.pdf;jsessionid=CEB145CD6BF4344178A2F1CFAC5D0C0A.1_cid378?__blob=publicationFile&v=2.

25 Gönenç Gurkaynak, M. Hakan Özgökçen & Esen Ergül, *Turkey: An Overview on the Turkish Competition Board's Recent Phase II Decisions*, Mondaq, June 24, 2015, http://www.mondaq.com/turkey/x/406954/Trade+Regulation+Practices/An+Overview+On+The+Turkish+Competition+Boards+Recent+Phase+Ii+Decisions.

26 The enforcement of foreign-to-foreign transactions is rare in many other jurisdictions as well. *See, e.g.*, Denmark ("Only on rare occasions have remedies been necessary in foreign-to-foreign mergers,"); Israel ("To date, only in a few cases of foreign-to-foreign mergers have remedies been required."); Norway (since the current Competition Act came into effect in 2004, the Norwegian Competition Authority has intervened in 35 merger cases and only four involved foreign-to-foreign transactions). *See* Getting the Deal Through (John Davies ed., 2015), https://gettingthedealthrough.com/area/20/merger-control/.

27 Press Release, CADE, Cade celebra primeiros Acordos em Controle de Concentrações (May 22, 2013), http://www.cade.gov.br/Default.aspx?3ff20316ef25fb071320300256fe; Eur. Comm'n, Decision, Case M.6576 (May 24, 2013), *available at* http://ec.europa.eu/competition/mergers/cases/decisions/m6576_20130524_20600_4231067_EN.pdf.

28 Press Release, CADE, Cade celebra primeiros Acordos em Controle de Concentrações (May 22, 2013), http://www.cade.gov.br/Default.aspx?3ff20316ef25fb071320300256fe; Eur. Comm'n, Decision, Case M.6690 (May 29, 2013), *available at* http://ec.europa.eu/competition/mergers/cases/decisions/m6690_4017_2.pdf.

29 CADE, Decision, Proceeding No. 08700.004185/2014-50 (Jan. 29, 2015), *available at* http://sei.cade.gov.br/sei/institucional/pesquisa/documento_consulta_externa.php?a6_-38uSff0w6rlBdBW1VVbWwwvmOW7xmF6zCMe31m3573IKEOhklTV5V-ygvN_CoXd99Ef5asXC2rXTNHyGDg; DOJ, Decision, Case 1:14-cv-02087 (Mar. 30, 2015), *available at* http://www.justice.gov/file/492816/download.

30 Can. Competition Trib., Decision, Case CT-2014-008 (Nov. 26, 2014), *available at* http://www.ct-tc.gc.ca/CMFiles/CT-2014-008_Registered%20Consent%20Agreement_2_38_11-26-2014_7467.pdf; FTC, Decision, Case No. 1410187 (Jan. 21, 2015), https://www.ftc.gov/system/files/documents/cases/150121medtroniccovidiendo.pdf.

31 MOFCOM, Announcements, http://fldj.mofcom.gov.cn/article/ztxx/?.

32 MOFCOM also required the parties to divest a copper mine in Peru and ultimately approved its sale to a Chinese buyer.

authorities. Finally, while less clearly protectionist, MOFCOM's remedies in Western Digital/HGST and Samsung/Seagate, which required the hard disk drive companies to hold separate and independently operate their existing and acquired businesses, prevented the full realization of the pro-competitive benefits of those transactions.

I. What are the costs of globalization?

At its worst, globalization can prevent or destroy pro-competitive transactions. A single jurisdiction can destroy the pro-competitive benefits of a deal by blocking the transaction entirely or imposing a remedy that prevents the realization of the transaction's anticipated efficiencies, like some of the MOFCOM examples discussed above.

Improperly blocked transactions and inefficient remedies are, fortunately, uncommon. Far more common is the scenario where additional reviews dramatically extend the timeline of the antitrust review of a transaction, resulting in significant delay in its closing. This too is a serious concern. Delay in a single jurisdiction can delay the realization of substantial efficiencies globally. Moreover, the extent of such delays is likely greater than is immediately apparent because merging parties (and authorities) are influenced by the known timing of other jurisdictions. For instance, if a transaction requires a full-form filing with MOFCOM, all involved understand that there will be a four- to seven-month (or longer) review process in China, which can reduce the incentive to move things along more quickly in the United States and elsewhere.

Such delay imposes real costs. Since the 1970s, when the US Hart-Scott-Rodino Antitrust Improvements Act was passed, economic knowledge about the effects of corporate transactions has exploded.[33] While there was once skepticism that mergers could generate significant efficiencies, more recent economic work has concluded that mergers often reduce costs and increase efficiency, resulting in increased innovation, greater output, and lower prices.

It is now widely recognized that corporate transactions are often a pro-competitive improvement on the pre-transaction status quo.[34]

Mergers can also lead to reduced costs of production and/or distribution by allowing parties to shift manufacturing from higher-cost assets to lower-cost assets, or by optimizing distribution networks to reduce transportation costs.[35] And mergers that increase the parties' scale (production volume) and/or scope (range of products produced) can also lead to lower costs.[36]

Mergers can also generate important R&D efficiencies. Indeed, there are several ways in which mergers can enhance innovation. For example, where the merging parties have complementary R&D assets,

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33 Notably, the 1982 Merger Guidelines were highly skeptical that efficiencies should even be considered in merger analysis, restricting their consideration to "extraordinary cases." U.S. Dep't of Justice, Merger Guidelines (1982), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,102.

34 *See, e.g.*, William J. Kolasky & Andrew R. Dick, *The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers*, 71 Antitrust L.J. 207, 240 (2003) (describing how "the US courts and antitrust agencies have made substantial progress . . . in learning how to integrate efficiencies into their evaluation of potentially anticompetitive mergers").

35 *See, e.g.*, Joseph Farrell & Carl Shapiro, *Scale Economies and Synergies in Horizontal Merger Analysis*, 68 Antitrust L.J. 685, 695 (2001) (noting that mergers may generate "re-optimization" by optimizing distribution networks and production across facilities).

36 *See, e.g.*, Kolasky & Dick, *supra* note 34, at 244, 246 (2003).

innovation may accelerate when they are combined post-transaction.[37] More broadly, mergers can increase the incentive to innovate because a larger firm can benefit from spreading new innovations across a larger base of sales.[38] Moreover, any merger-generated increase in innovation can spur competitors to innovate themselves to keep up with the merging parties, further benefitting customers and consumers.[39]

Mergers and acquisitions are also part of another means to efficiency: a robust market for corporate control. Corporate transactions allow investors to identify poorly managed companies and bid to take them over. Post-takeover, underperforming management can be improved or replaced, allowing the company to operate more efficiently to the benefit of shareholders and customers.[40] Even the threat of a potential takeover drives efficiency within corporations; if managers underperform, they may be replaced by new ownership.[41]

A delay in closing is, by definition, a delay in the realization of these efficiencies and benefits. Where these efficiencies are significant, a delay in their realization can have a serious detrimental effect on consumers. Such delays are particularly concerning in high-technology industries, where markets evolve rapidly. A delay of even a few months in realizing R&D synergies can prevent merging parties from keeping pace with industry change and put them permanently behind competitors.

Moreover, it is widely recognized that the pendency of a corporate transaction has a negative impact on the companies' operations. This concern is particularly acute at the target where, given gun-jumping concerns and interim operating covenants, there can be paralysis in terms of corporate decision-making. Even if the target is contractually able to make major changes to its business, it may be unwilling to do so while its acquisition is pending. At the same time, at either company, there is also a risk that the company takes action that is in its best interest as an independent company but that is inefficient for the combined company. Once again, the stakes are higher in high-tech industries, where a few months of paralysis or delay can mean falling far behind in R&D. More generally, there is significant uncertainty for customers, suppliers, and employees, all of whom may be tempted to jump ship during the pendency of a transaction. Finally, across industries, delay also imposes basic financial costs: the need to secure additional or more expensive financing or pay additional interest.

Corporate executives, of course, recognize these issues and factor them in when deciding whether to pursue a corporate transaction (and what price to offer or accept). Essentially, these risks function as a tax on otherwise pro-competitive corporate transactions. In extreme cases, this tax may deter companies from pursuing transactions altogether. As Daniel Cooperman, former General Counsel of Oracle, explained, "[w]hether delay results from procedural overload or duplication, or from the sincere regulatory pursuit of an aggressive but unverifiable theory of competition, the additional time spent in the regulatory process may be the largest and most important transactions cost of all—and the one that thwarts the most potentially

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37 *See, e.g.*, Gary L. Roberts & Steven C. Salop, *Efficiencies in Dynamic Merger Analysis*, 19(4) World Competition L. & Econ. Rev. 5, at 8 (1996).

38 *See, e.g.*, *id*.

39 *See, e.g.*, *id*. ("Mergers can also lead to diffusion of cost savings over time through the broader process of inducing competitive innovation. Competitive pressure may spur rival firms to increase their independent investments in order to keep up with the newly merged entity.").

40 *See, e.g.*, Henry Manne, *Mergers and the Market for Corporate Control*, 73 J. Pol. Econ. 110, 113 (1965) ("As an existing company is poorly managed—in the sense of not making as great a return for the shareholders as could be accomplished under other feasible managements—the market price of the shares declines relative to the shares of other companies in the same industry or relative to the market as a whole . . . the lower the stock price, relative to what it could be with more efficient management, the more attractive the take-over becomes to those who believe that they can manage the company more efficiently.").

41 *See e.g.*, *id*.; Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. Pa. L. Rev. 713, 720 (2003).

procompetitive transactions."[42] These considerations also may be a factor when sellers are evaluating which buyer to sell to—sellers may make decisions based in part on filing requirements and their resulting implications for deal timing, rather than best strategic fit or best return to shareholders.

Even where transactions are not deterred or unduly delayed, the expansive regulatory process results in substantial administrative costs that should not be ignored. Preparation of filings is costly and time-consuming. Merging parties must retain counsel in individual filing jurisdictions and, in most cases, must collect substantial information about the business in each jurisdiction. Often, particularly in smaller jurisdictions or jurisdictions where the parties are minimally active, the required information simply does not exist in the ordinary course of business. Companies do not invest in the competitive intelligence needed to track product level shares in jurisdictions where they have tens of thousands of dollars in sales, yet many jurisdictions ask for exactly this information. The cost of gathering this information is particularly high because the people best positioned to collect it are typically businesspeople in the overlap product areas, who must be diverted from the important work of integration planning, which is critical to the success of a merger. (The fact that this information does not exist and must be estimated in many cases also raises the question of how useful this information is to the authorities.)

Several jurisdictions also have significant filing fees. For example, the Common Market for Eastern and Southern Africa ("COMESA") requires a filing fee of up to US$200,000 (down, in response to international outcry, from US$500,000); in the UK, filing fees can be as much as £160,000; and in Germany, filing fees can be as much as €100,000 for significant cases. Such fees function as yet another tax on pro-competitive transactions and create a perverse incentive for jurisdictions to lower their thresholds and increase the number of transactions reviewed, regardless of whether there is any real risk to competition.

This system does not serve consumers well, and this tax on global transactions can be reduced without jeopardizing them. But developing a system that can identify and resolve local problems without imposing undue burden and delay on global transactions will require significant international coordination that goes well beyond the formal and informal cooperation that many authorities undertake today.[43] Moreover, successfully reducing this tax will require acknowledging that having a dozen decision-makers review the same transaction simply cannot be efficient and, worse, has the potential to seriously undermine economic efficiency and consumer welfare.

Unfortunately, there may be little appetite within any particular jurisdiction to move toward a coordinated regime: regulators face a perverse incentive from collecting filing fees, regulators and practitioners depend on filings for their livelihood, and the culture of the international competition community rewards activism over passivity.

It is time for the international competition community to consider whether, notwithstanding its worthy goals, the globalization of merger enforcement has gone too far. We sketch out below proposed initial steps that individual regulators can take to reduce the costs of global merger control without interfering with their ability to step in when a transaction is truly anticompetitive. While insufficient to remedy all

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42 Daniel Cooperman, Senior Vice President, Gen. Counsel & Sec'y, Oracle Corp., Testimony before the Antitrust Modernization Commission, at 1 (Nov. 8, 2005), http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Statement_Cooperman.pdf.

43 There is no doubt that extensive cooperation among agencies is a reality of the antitrust world today. For example, the DOJ reports that it worked with other enforcers in 40% of its merger challenges over the last five years. *See* Bill Baer, Assistant Attorney Gen., Dep't of Justice, *Cooperation, Convergence, and the Challenges Ahead in Competition Enforcement*, Remarks at the Ninth Annual Global Antitrust Enforcement Symposium (Sept. 29, 2015), http://www.justice.gov/opa/speech/assistant-attorney-general-bill-baer-delivers-remarks-ninth-annual-global-antitrust. And the European Commission reports that it worked with agencies outside the EU in 58% of its complex merger investigations. *See* Eur. Comm'n, Report on Competition Policy 2014 at 17 (2015), http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0247&from=EN.

of the problems we have identified, we hope that these measures can serve as first steps toward realizing the goals of antitrust laws: enhancing efficiency, promoting economic growth, and benefitting consumers.

1. *Establish clear and thoughtful thresholds.* A simple first step towards getting merger control under control is for individual jurisdictions to take a hard look at their filing thresholds.[44]

To start, thresholds must be clear. Though this seems obvious, in some jurisdictions, companies cannot readily determine whether a filing is required. Market share thresholds in jurisdictions such as Spain, Portugal, and Taiwan require the parties to determine an antitrust relevant market and then estimate their own shares within that jurisdiction. And other jurisdictions have components of their thresholds that are far from clear—e.g., assessing the value of the "Mexican portion of the transaction" is a component of the Mexican filing threshold.

Thresholds must also require that a transaction have a clear nexus to the filing jurisdiction. To this end, we would prescribe a focus on the target's revenues or assets, requiring filings only where the target has more than *de minimis* turnover and/or assets in the jurisdiction. While there may be some exceptions, it is quite uncommon that a transaction will lead to competitive harm in a jurisdiction where a target has no or minimal presence. Yet many jurisdictions require filings where the target has a *de minimis*—or less—presence in the jurisdiction. In several countries, including Macedonia, a filing may be required even where one party has *no sales* in the country. Many more countries have thresholds that can be satisfied by only a *de minimis* local presence (e.g., Slovenia, which requires only €1 million in local target turnover, and Ukraine, which requires just €1 million in local turnover or assets by either party).[45]

2. *Create a "fast track" mechanism allowing for quick clearance.* While not eliminating the costs of notification, creating a "fast-track" process where parties can be confident that transactions that do not raise competitive concerns will be cleared quickly, eliminates some of the uncertainty and related problems associated with the merger control process. (Of course, this depends on having a fair, economically sound review process with no non-competition issues distorting the process.)

In order for a fast-track process to work, several conditions must be met: First, the form itself must not be so onerous that just completing it will require weeks of effort. Second, there must be a firm timeline that begins when a filing is submitted—meaning no "pre-consultation" period like those in the EU, China, Romania, and the Ukraine. And finally, the review period must be short—ideally, 30 days or less. The timeline should be the rule, not a guideline, as even where clearances are in practice granted quickly (as is often, but not always, the case in Brazil), the prospect of a protracted review process leads to uncertainty even where no competitive concerns are ultimately identified.

3. *Focus on local transactions.* Where multi-national deals are reported in individual jurisdictions, regulators should recognize that most global deals need not be enforced in each and every jurisdic-

44 We would also propose ensuring that the agency determining the thresholds is independent from the agency that receives the fees so as to reduce the incentive to set low thresholds in order to collect additional filing fees.

45 When we prescribe a focus on the "target," we mean the business that is actually being acquired. Certain jurisdictions, including Brazil and, in some transactions, South Korea, look at *target group* turnover rather than *target* turnover. As a result, transactions involving minimal (or no) sales in those jurisdictions may still need to be notified. In February 2015, for example, the global acquisition of semiconductor manufacturer Lantiq Holdco S.A.R.L. by Intel Corporation required notification in Brazil—where the target had negligible Brazilian sales and accounted for less than 1% of the Brazilian market—because the target group's turnover, including sales by companies who had a common controlling shareholder and the companies in which they had an interest of 20% or more, exceeded the Brazilian turnover thresholds. *See* CADE, Merger Case No. 08700.000486/2015-95.

tion. Instead, in cases where the relevant markets are global and the required divestitures are not local, jurisdictions should coordinate with and defer to other jurisdictions imposing remedies (particularly those most directly affected, which often will be the EU and United States) rather than impose a "me too" consent decree, as Canada required in Medtronic/Covidien and Brazil required in Munksjö/Ahlstrom and Mach/Syniverse.

4. *Pursue (at least) "soft convergence."* A standardized merger filing that multiple jurisdictions could accept—perhaps requiring basic corporate information, market shares, top customers globally and in each triggered jurisdiction, and the 4(c)/(d)-type documents required in the United States and by the European Commission—should replace the hodgepodge of forms required by the multitude of jurisdictions.[46] The aim would be a "soft," voluntary convergence that could evolve further, while increasing efficiency and certainty for companies in the meantime.

We are, of course, quick to recognize that the United States is not immune to many of the criticisms raised above. The US filing thresholds pick up a tremendous number of transactions that raise no competitive issues. In fiscal year 2014, only about 3% of notified transactions (51 of 1,618) reviewed by the US competition authorities received a Second Request,[47] and only 33 transactions were ultimately challenged or cleared with a remedy.[48] And over 80% of requests for early termination were granted.[49] Clearly, a significant number of US merger filings involve transactions that raise no competitive concerns, and it is worth considering how the United States could revise its rules to eliminate many of these filings and the accompanying filing fees (as high as US$280,000) and delay. (It seems to us that optimizing the notification requirements based on real-world experience would be a worthy project for the FTC's economists.)

One possibility would be to exempt transactions where there is objectively no overlap between the merging entities, e.g., no horizontal overlap at the six-digit NAICS code level. While this would not capture vertical transactions, the competition concerns they raise are typically addressed with conduct remedies that can be implemented post-closing. To the extent that some small number of transactions that raise horizontal concerns (e.g., potential competition transactions) were not captured, the US agencies would still have jurisdiction to investigate and even sue to block those transactions, just as they can do today with transactions that fall below the filing threshold.

Relatedly, it is also worth considering whether the US thresholds should be raised further than the typical annual adjustment for inflation (a mechanism we would urge other agencies to adopt), especially given the agencies' continued ability to enforce transactions valued below the threshold. This approach would be consistent with FTC and DOJ practice, where investigations are heavily weighted toward high-dollar value transactions. In fiscal year 2014, transactions valued over US$1 billion constituted just 14% of total transactions notified in the United States, but represented 49% of Second Requests issued.[50] In contrast, transactions valued below US$200 million constituted 40.8% of transactions notified, but represented just 11.8% of Second Requests issued.[51]

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46 For those in the United States, this could be viewed as akin to the "Common Application" completed by college applicants.

47 Fed. Trade Comm'n & Dep't of Justice, Hart-Scott-Rodino Annual Report: Fiscal Year 2014 30, *available at* https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino.s.c.18a-hart-scott-rodino-antitrust-improvements-act-1976/150813hsr_report.pdf.

48 *Id*. at 2. This figure includes challenges to transactions that were below the notification threshold.

49 *Id*. at 22 (noting that early termination was granted in 1,020 transactions of 1,618 transactions in which a Second Request could have been issued; early termination was only requested in 1,274 of those transactions).

50 *Id*. at 30.

51 *Id*.

Another shortcoming of the current US model is that both state and federal agencies can enforce transactions. Like their global counterparts, "me too" consent decrees with state attorneys general in cases that have been enforced by the FTC or DOJ add little protective value, but add sometimes significant administrative cost and potential for delay. For example, in 2009, the FTC investigated the acquisition of Morton International by K+S Aktiengesellschaft in response to concerns that the proposed transaction would harm competition in the market for bulk road salt in Maine and Connecticut. The FTC ultimately required divestitures in those states.[52] The Connecticut Attorney General conducted a parallel investigation, which was resolved by an agreement to divest the same set of assets—and pay US$40,000 toward the costs of the state investigation.[53] In the 2015 Safeway/Albertsons case, the FTC required the divestiture of 168 grocery stores in eight states.[54] State attorneys general in Nevada, Washington, and California each required a subset of the FTC divestitures.[55] Safeway was required to pay attorneys' fees and costs to the state agencies.[56] Though the mechanisms for practical implementation might be challenging, we would strongly support reforming the US system such that state attorneys general only have jurisdiction over mergers with purely intrastate effects.

* * *

We should note that there are some encouraging signs that the international community is aware of and responding to these concerns. For example, effective January 1, 2014, the European Commission implemented measures aimed at simplifying the EU merger regime, including by, among other things, expanding the scope of transactions that can be reviewed under the Commission's simplified procedure, reducing the amount of information required in the notification form (particularly under the simplified procedure), and making it easier for companies to seek a referral to or from a member state.[57] MOFCOM introduced a simplified process in February 2014 for cases with combined market shares below 15%. In the first year that MOFCOM's simplified process was in place, simple cases were reviewed in an average of 29 days after MOFCOM accepted the filing, though the pre-acceptance review period still takes several weeks and introduces significant uncertainty.[58] More recently, MOFCOM has introduced additional reforms aimed at continuing to streamline the merger review process.[59] While there is reason to be skeptical about these proposals, the response to international concern is encouraging.

But there is still work to be done. Though the economic paradigm has shifted to acknowledge that corporate transactions can in fact be pro-competitive, and though many agencies have recognized this in

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52 Fed. Trade Comm'n, Decision and Order, No. C-4273 (Nov. 13, 2009), *available at* https://www.ftc.gov/sites/default/files/documents/cases/2009/11/091113mortonsaltdo.pdf.

53 Press Release, Conn. Office of the Attorney Gen., Attorney General Announces Agreement Preserving Competition in Connecticut's Deicing Road Salt Market (Nov. 20, 2009), http://www.ct.gov/ag/cwp/view.asp?A=2341&Q=451152.

54 Fed. Trade Comm'n, Decision and Order, No. C-4504 (July 2, 2015), *available at* http://www.ftc.gov/system/files/documents/cases/150702cerberusdo.pdf.

55 Press Release, Safeway, Albertsons and Safeway Receive U.S. FTC Clearance for Proposed Merger (Jan. 27, 2015), http://investor.safeway.com/phoenix.zhtml?c=64607&p=irol-newsArticle_pf&ID=2010943.

56 *See Washington v. Cerberus Institutional Partners V., L.P.*, 2:15-cv-00147-JCC (W.D. Wash. Jan. 30, 2015), Consent Decree (awarding US$28,000 in attorneys' fees and costs); *Nevada v. Cerberus Institutional Partners V., L.P.*, 2:15-cv-00176-JAD-NJK (D. Nev. Feb. 3, 2015) (awarding US$90,000 in attorneys' fees and costs).

57 Press Release, Eur. Comm'n, Mergers: Commission cuts red tape for businesses (Dec. 5, 2013), ec.europa.eu/rapid/press-release_IP-13-1214_en.pdf.

58 Cleary Gottlieb Steen & Hamilton LLP, Asian Competition Quarterly Report: January – March 2015 at 1 (2015), http://www.cgsh.com/files/Publication/f4e5265f-253d-422c-a966-1b234abe9d3b/Presentation/PublicationAttachment/84297c26-73c1-4a00-8a3c-1b7c16ebab67/Asian_Competition_Report_1Q_2015.pdf.

59 Melissa Lipman, *Chinese Merger Reviews May Move Faster After Changes*, Law360, Sept. 18, 2015, http://www.law360.com/articles/703033/chinese-merger-reviews-may-move-faster-after-changes.

their substantive standards, regulators have been slow to reflect this paradigm shift in their procedural requirements. Further work is needed to encourage regulators, particularly those in emerging jurisdictions, to recognize that their role of preserving and promoting competition means not only preventing anticompetitive transactions but also facilitating prompt clearance of the many transactions that affirmatively benefit consumers.

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Key Contacts

Edwin Kwok
Hong Kong
D: +852-3512-2380

Ke Geng
Beijing
D: +86-10-6563-4261

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Recent Developments in Corporate Transactions Involving Shell Companies Listed on the Hong Kong Stock Exchange

January 20, 2017

Introduction

2016 is another active year for the acquisitions, disposals and restructurings of shell companies listed on The Stock Exchange of Hong Kong Limited (HKSE). Market participants appear to have gradually become accustomed to the requirements published by the HKSE in guidance letter HKEx-GL78-14 (May 2014) which clarifies the requirements for triggering a reverse takeover (RTO) and extreme very substantial acquisition (Extreme VSA), and guidance letter HKEx- GL84-15 (December 2015) which clarifies the cash company rules for issuers engaging in large scale fundraising activities.

As the size of a shell company is typically very small and a common feature of these transactions is that the shell company will proceed to operate a new business which is substantially larger than the original business, a key issue in structuring transactions involving shell companies is to consider whether the proposed transaction will trigger the principles set out in the two guidance letters, as well as the requirement that an issuer must have a sufficient level of operations or assets to warrant the continued listing of its securities under Main Board Listing Rule 13.24 or GEM Listing Rule 17.26. In 2016, the HKSE published a series of listing decisions to illustrate how it would apply these principles in practice. This article* discusses the implication of the guidance letters and the relevant listing decisions as well

as their impact on structuring a transaction of this nature.

Guidance Letter HKEx-GL78-14 (the RTO Guidance Letter)

Definition of RTO and Extreme VSA

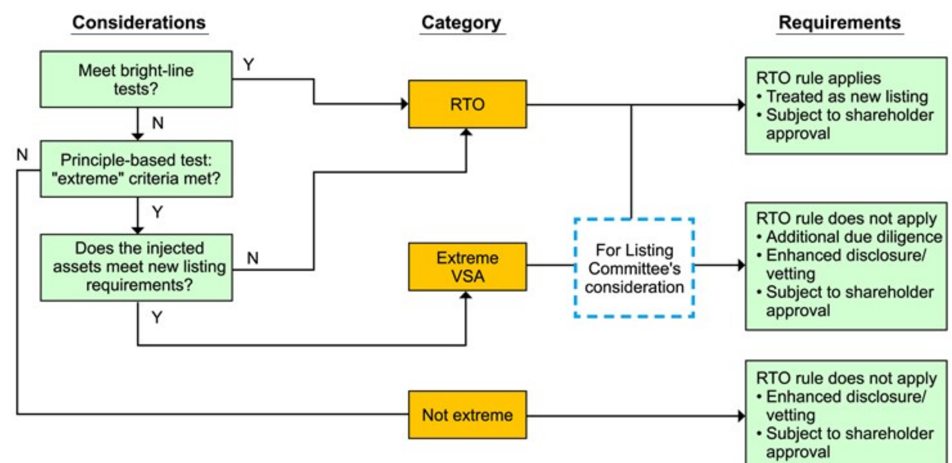
The RTO Guidance Letter explains that under Main Board Listing Rule 14.06(6) and GEM Listing Rule 19.06(6), there are two applicable tests to determine whether an acquisition constitutes an RTO, namely the "principle based test" and the "bright line tests". Under the principle based test, an RTO refers to an acquisition or a series of acquisitions of assets which, *in the opinion of the HKSE*, constitutes an attempt to achieve listing of the assets to be acquired and a means to circumvent the listing requirements for new listing applicants. The words *in italics* indicate that the principle based test involves an application of judgment by the HKSE rooted on the principle that RTO rules are anti-avoidance provisions designed to prevent circumvention of the new listing requirements. On the other hand, the bright line tests have two limbs and triggering either of them will give rise to an RTO — (i) an acquisition (or a series of acquisitions) which constitutes a very substantial acquisition[1] where there is or which will result in a change in control of the issuer; or (ii) an acquisition (or acquisitions) from the incoming shareholder or his associate(s) within 24 months of the incoming shareholder gaining control, which individually or together constitute a very substantial acquisition. The term "control", as defined in the Takeovers Code, means a holding, or aggregate holdings, of 30% or more of the voting rights of a company, irrespective of whether that holding or holdings gives *de facto* control.

Prior to the publication of the RTO Guidance Letter and perhaps due to the lack of guidance on the principle based test, there was a tendency by certain market participants to treat the bright line tests as the defining benchmarks for RTOs. Before, it was not uncommon to have the confusion that where there is no change of control, a proposed transaction will not be treated as an RTO. Subsequent to the publication of the RTO Guidance Letter, it is now clear that a transaction may be treated as an RTO under the principle based test even if it falls outside either of the two limbs of the bright line tests. The flowchart below sets forth the correct thinking process in considering whether the RTO rules apply.

To recap, where a proposed transaction falls outside the bright line tests but is treated as "extreme" under the principle based test, and the injected assets do not meet new listing requirements,[2] the proposed transaction will be treated as an RTO. If, however, the injected assets can satisfy the new listing requirements, the proposed transaction will be treated as an Extreme VSA and presented to the Listing Committee to further resolve whether the RTO rules apply. If the Listing Committee decides that the RTO rules do not apply, it will require the issuer to prepare a shareholders' circular under an enhanced disclosure and vetting regime and appoint a financial adviser to conduct due diligence on the acquisition. The extent of the financial

adviser's work and scope of the due diligence should be referenced to Practice Note 21 to the Main Board Listing Rules or Practice Note 2 to the GEM Listing Rules. In undertaking that due diligence, the financial adviser is expected to refer to the procedures that sponsors would typically perform.

The RTO Guidance Letter states that where a *very substantial acquisition* is not considered to be an RTO but amounts to a material change to the issuer's business, management and/or mode of operations, the issuer may nevertheless be required to prepare a shareholders' circular under an enhanced disclosure and vetting regime but without the need to appoint a financial adviser to conduct additional due diligence. In short, the enhanced disclosure and vetting regime will include a lot more information about the target and the future business prospects of the issuer, applying the standard of disclosure for listing documents for new listing applicants. A major transaction or discloseable transaction, which is not extreme, is not subject to the enhanced disclosure and vetting regime.



Source: The RTO Guidance Letter

What constitutes an "extreme" transaction

The RTO Guidance Letter puts forth the following criteria for the HKSE to determine whether an acquisition should be regarded as "extreme":

(i) size of the acquisition relative to the size of the issuer;

(ii) quality of the business to be acquired — whether it can meet the trading record requirements for listings or whether it is unsuitable for listing;

(iii) nature and scale of the issuer's business before the acquisition (e.g. whether it is a listed shell);

(iv) any fundamental change in the issuer's principal business (e.g. the existing business would be discontinued or very immaterial to the enlarged group's operations after the acquisition);

(v) other events and transactions (historical, proposed or intended) which, together with the acquisition, form a series of arrangements to circumvent the RTO rules (e.g. a disposal of the issuer's original business

simultaneously with a very substantial acquisition); and

(vi) any issue of restricted convertible securities to the vendor which would provide it with de facto control of the issuer.

Consequences of triggering an RTO

Where a proposed transaction is treated as an RTO, according to Main Board Listing Rule 14.54 and GEM Listing Rule 19.54, the HKSE will treat the issuer as if it were a new listing applicant. It will be required to comply with all applicable listing requirements for new applicants, in particular, the enlarged group or assets to be acquired must meet the track record requirements for new applicants under Main Board Listing Rule 8.05 or GEM Listing Rule 11.12A, and the enlarged group must meet all other new listing requirements under Chapter 8 of the Main Board Listing Rules or Chapter 11 of the GEM Listing Rules. An RTO must also be approved by the shareholders of the issuer and the shareholders' circular needs to be a listing document applying the same disclosure standards applicable to the prospectus of a new listing applicant. The issuer is also required to appoint a sponsor for the new listing application.

Guidance Letter HKEx-GL84-15 (the Cash Company Guidance Letter)

As an alternative method to make the acquisition of shell companies faster and easier, from the beginning to mid-2015 a number of issuers proposed large scale fundraising activities involving injections of substantial amount of cash into the issuer by their acquirers in exchange for new shares and/or convertible securities to be issued by these issuers to their acquirers and/or their affiliates. One obvious advantage of this approach is that the acquirer can legitimately avoid the need to extend general offers to shareholders of the issuer through obtaining a whitewash waiver from the Securities and Futures Commission under the Takeovers Code, assuming the relevant dispensation conditions under the notes on dispensations from Rule 26 and Schedule VI of the Takeovers Code are duly met. The issuer will then be equipped with a significant amount of cash to prepare for its future acquisitions and/or operations.

Before the publication of the Cash Company Guidance Letter, the requirements under Main Board Listing Rules 14.82 to 14.84 and GEM Listing Rules 19.82 to 19.84 — namely, that if the assets of an issuer (except an investment company as defined under Chapter 21 of the Main Board Listing Rules and a company solely or mainly engaged in the securities brokerage business) consist wholly or substantially of cash or short-dated securities such as bonds, bills or notes with less than one year to maturity, it will be regarded as a cash company not suitable for listing — were not entirely clear as there was no clear definition for a cash company. The consequences for being deemed as a cash company are serious as trading for its shares must be suspended and the issuer may only apply to the HKSE to lift the suspension once it has a business suitable for listing.

The HKSE will treat such application as if it were for a new listing.

Whilst the Cash Company Guidance Letter states that there is no prescribed quantitative threshold in the Listing Rules to assess whether a company's assets consist substantially of cash, in general an issuer with less than 50% of its total assets being cash as a result of a fundraising will not be regarded as a cash company. Conversely, It will massively increase the chance of the issuer being deemed as a cash company if more than 50% of its total assets consist of cash. A holistic approach should be taken to assess all background facts and circumstances of the issuer's business, operation and financial position on a case-by-case basis. Some common features of a cash company include: (i) engaging in a significant size of fundraising with no or little correlation with the issuer's current business; (ii) using funds raised in largely greenfield operations of new businesses with no or little correlation with the issuer's current business; (iii) the fund providers acquiring control of the issuer and intending to manage the new businesses; and (iv) the issuer operating new businesses substantially larger than the original business.

Summary and Analysis of a Series of Listing Decisions Published in 2016

In March 2016, the HKSE published a series of listing decisions that provide additional insight and practical examples on how the HKSE would apply the principles set out in the guidance letters in practice.

HKEX-LD94-2016

This issuer carried on the principal business of property investment, fund management and fund and securities investment. It proposed to subscribe for an interest as a limited partner in a fund for approximately HK$4.5 billion, which was about 80% of the size of the fund and over 900% of the issuer's market capitalization. The fund was a newly established partnership. It did not have any investments, assets or liabilities, and had not recorded any income or expenses. The issuer submitted that the fund had a clear investment objective to invest in debt instruments of PRC real estate developers and the proposed subscription allowed the issuer to leverage on the fund to source and manage potential investments in the PRC real estate market.

Whilst the proposed subscription fell outside the bright line tests (i.e., there was no change of control in the issuer), the HKSE applied the principle based test with reference to the criteria set out in the RTO Guidance Letter to treat the proposed subscription as an RTO. The key determining factors included the fund not having any track record to demonstrate satisfaction of the profit requirements under Main Board Listing Rule 8.05; the size of the subscription was significant to the issuer and the issuer had no control over or right to participate in the management of the fund or the investments to be made by the fund. All these raised concerns about the issuer's suitability of listing upon completion of the subscription.

HKEX-LD95-2016

This issuer manufactured and sold household products. It proposed to acquire a target that had not yet started operation in holding inventories, machinery and equipment for the production of beverage products. The asset ratio and the consideration ratio for the proposed acquisition was about 300% and 200%, respectively. The issuer would satisfy the consideration by issuing new shares and convertible bonds (with a conversion restriction that prevented owner of the target from holding a 30% interest or higher in the issuer) to the vendor of the target. As a result, the vendor would become the single largest shareholder (28%) of the issuer upon completion of the acquisition.

This is another instance where the proposed acquisition fell outside the bright line tests (i.e., there was no change of control in the issuer) but, after applying the principle based test, the HKSE considered that the proposed acquisition would constitute an RTO and the listing requirements would be circumvented as the target did not have any trading record to meet the profit requirement for new listings, and it had to rely heavily on another company for both the production and sale of its products. Not only was the value of the target's assets significant to the issuer (approximately three times of the issuer's asset value), the target's business was also entirely different from the issuer's existing business. The proposed acquisition would be a means for the owner of the target to list the target by injecting it into the issuer.

This issuer subsequently submitted a revised proposal to only acquire 30% interest in the target, thereby reducing the asset ratio and consideration

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Key Contacts

C. Brophy Christensen
San Francisco
D: +1-415-984-8793

Shelly Heyduk
Newport Beach
D: +1-949-823-7968

Robert Plesnarski
Washington, DC
D: +1-202-383-5149

Eric Sibbitt
San Francisco
D: +1-415-984-8777

Paul Porter
San Francisco
D: +1-415-984-8973

PDF

Is It Time for You to Implement a Virtual Annual Meeting?

March 15, 2017

Modern electronic communications technology has dramatically expanded the opportunities for engagement between public companies and their shareholders through means such as webcast earnings calls; social media, including Twitter; telephonic or online access to in-person annual shareholder meetings; online roadshows and the like. However, it is only recently that an increasing number of prominent public companies have started to replace in-person annual meetings with virtual annual meetings conducted exclusively online. Companies such as HP, Intel, Fitbit, Sprint, and GoPro have in just the last two years held electronic-only virtual meetings for the first time, enabled by more advanced virtual meeting technology.

Virtual annual meetings offer benefits to both companies and shareholders. For example, a virtual meeting eliminates the costs of an in-person meeting, including travel for shareholders and a company's directors and management, thereby allowing shareholders more time to attend a greater number of meetings, as well as minimizing the amount of time that directors and management must spend at meetings. This potentially has the effect of increasing the participation of shareholders who would not otherwise be able to travel. For a number of smaller public companies, the choice to hold a virtual annual meeting acknowledges the reality of sparse attendance by shareholders. Virtual meeting platforms also provide the option to allow questions to be submitted in advance, which allows companies to focus on shareholder questions and prepare comprehensive answers. Virtual meetings also give companies the appearance of being "tech-savvy."

Virtual shareholder meetings, however, have some downsides. Certain

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institutional shareholders and shareholder activists believe that virtual shareholder meetings make it more difficult to express their views to management than in-person meetings, because virtual meetings are less personal and also because of the potential for management to pre-screen questions to avoid addressing shareholder concerns. In particular, both CalPERS and CII believe that virtual meetings should be used only as a supplement to in-person meetings (so-called "hybrid" shareholder meetings). Some shareholder activists have even submitted shareholder proposals under Rule 14a-8 of the Securities Exchange Act of 1934 requesting companies that have adopted virtual shareholder meetings to switch back to in-person meetings (although the SEC staff has generally permitted exclusion of these proposals on the basis that they relate to a company's ordinary business operations). And while proxy advisory firms such as Institutional Shareholder Services and Glass Lewis have not published written policies against virtual annual meetings, they may make adverse recommendations if virtual meetings were being used to thwart shareholder discussions or proposals. In addition, virtual meetings may make voting outcomes less certain because the ease of shareholder voting means that more shareholders may wait until the meeting to vote their shares (rather than submitting their proxies in advance) or may make last-minute changes to their votes. This is particularly a concern for shareholder meetings involving contentious shareholder votes.

Virtual Meeting Best Practices

To address some of these concerns, institutional investors, public company representatives, proxy advisors, and others have advocated for best practices, such as the guidelines published by the Best Practices Working Group for Online Shareholder Participation in Annual Meetings, which include:

- Adoption and advanced publication of principles for online participation in the virtual shareholder meeting;
- Establishing procedures to validate meeting participants as shareholders, and to facilitate voting and the proper recording of votes;
- Establishing reasonable guidelines for questions, such as procedures for submitting questions in advance, setting time limits for questions asked of management, and setting specific and reasonable guidelines for the display of questions and answers;
- Making arrangements for shareholders to present shareholder proposals; and
- Archiving the meeting on a publicly available website for a specific and reasonable period of time.

Certain Considerations

State Law

The corporate codes of each state provide requirements for the conduct of annual meetings of shareholders. Some states allow virtual-only meetings, such as Minnesota, Ohio, Pennsylvania, and Texas. However, some of

these states (including California) impose onerous conditions, including shareholder consents, to hold a virtual-only meeting.

The Delaware legislature has enacted specific provisions in the Delaware General Corporation Law (DGCL) that have facilitated virtual shareholder meetings. In particular, Section 211 of the DGCL enables Delaware corporations to hold shareholder meetings solely by means of “remote communication.” Section 211 also allows shareholders to use remote communication to (1) participate, (2) be deemed present, and (3) vote at an annual shareholder meeting, “provided that (i) the corporation shall implement reasonable measures to verify that each person deemed present and permitted to vote at the meeting by means of remote communication is a stockholder or proxyholder, (ii) the corporation shall implement reasonable measures to provide such stockholders and proxyholders a reasonable opportunity to participate in the meeting and to vote on matters submitted to the stockholders, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with such proceedings, and (iii) if any stockholder or proxyholder votes or takes other action at the meeting by means of remote communication, a record of such vote or other action shall be maintained by the corporation.”

Other than as pertains to proxies, the United States federal securities laws do not impose any requirements on companies for annual meetings. In addition, stock exchanges such as the NYSE require listed companies to hold annual meetings, but do not impose limitations on virtual shareholder meetings. NASDAQ permits the use of webcasts instead of, or in addition to, an in-person meeting, provided such webcasts are permissible under the relevant state law and shareholders have the opportunity to ask questions of management.

Bylaw Provisions Enabling Virtual Shareholder Meetings

In addition to selecting an appropriate vendor to provide the technology platform for a virtual shareholder meeting, a company would need to ensure that its governing documents permit virtual meetings. The bylaws of Delaware corporations in particular typically state that companies need to provide advance notice to shareholders of the time and *place* of a shareholder meeting. Even if the bylaws are flexible and, for example, allow shareholder meetings to be held anywhere in the United States or as may be designated in the meeting notice, the bylaws may still be too restrictive to allow for a virtual meeting. As a result, some Delaware corporations have added specific language to their bylaws to expressly permit virtual shareholder meetings.

For Delaware corporations, any amendments to bylaws necessary to enable a virtual shareholder meeting should generally be put in place on or prior to the record date, as Section 213 of the DGCL requires that the record date for an annual meeting may not precede the date upon which the resolution fixing the record date is adopted by the board of directors.

Planning and Logistics

Companies planning to do a virtual shareholder meeting should choose a technology platform vendor such as Broadridge or Computershare early in the planning process to be able to familiarize themselves with the platform and to ensure the meeting is free of technical glitches.

Conclusion

In the past, traditional in-person shareholder meetings were a critical venue for the discussion of corporate affairs. In light of developments in communications technology and social media, the channels for companies to engage with shareholders and for shareholders to express their views have diminished the utility of the in-person shareholder meeting. As a result, virtual-only shareholder meetings are becoming increasingly popular and offer a number of benefits for both shareholders and companies. However, to address and mitigate certain downsides and shareholder concerns, companies seeking to hold virtual-only meetings should strive to adhere to established best practices. In addition, companies seeking to hold virtual-only meetings should be mindful of corporate governance requirements and build the logistics of a virtual meeting into their meeting timeline.

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What to Expect From the SEC's New Cyber-Savvy Chair

Danielle C. Gray and Patrick D. McKegney, *New York Law Journal*

June 5, 2017

Wall Street lawyer and newly-confirmed Securities and Exchange Commission Chair Jay Clayton stands to be a central figure in the nation's awakening to cyber threats. Before his appointment, Clayton helped lead Sullivan & Cromwell's General Practice Group, where he was known for brokering mergers and acquisitions. Although his views on issues of data security are less well known, Clayton co-authored an article in 2015 on the need to acknowledge "how little we understand" about cybersecurity.[1] At his March confirmation hearing before the Senate Banking Committee, he offered a glimpse into his current thinking. In response to questions about potential legislation,[2] Clayton wondered aloud whether today's ordinary investor fully appreciates the cyber risks that he believes face all major companies. And when Sen. Mark Warner (D-Va.) pressed him on public companies' failures to disclose significant data breaches in SEC filings, Clayton did not blink. "As I look across the landscape of discussion and understanding of cyber threats and their possible impact on companies," he stated, "I question whether the disclosure is where it should be."

This acknowledgement of cyber risks and the need for consistent disclosures creates an evolving landscape for publicly traded companies. While the United States lacks a principal cybersecurity regulator, the SEC has implemented regulations in its purview and has begun to penalize companies that fail to comply. As Clayton begins his tenure at the SEC, here are a few areas to keep an eye on in the months ahead, in terms of legislation, regulatory guidance and enforcement activity.

Cybersecurity Disclosure Legislation

During his March 23, 2017 hearing, Clayton answered several questions about the Cybersecurity Disclosure Act, a bipartisan bill introduced earlier that month by Sens. Warner, Jack Reed (D-R.I.), and Susan Collins (R-Maine). The act directs publicly traded companies to disclose in SEC filings whether they have cybersecurity expertise on their boards. If such an expert is not in place, the company must explain why it considered the expertise unnecessary and what other steps it has taken. Although the act does not direct boards to hire a cybersecurity expert, the disclosure requirement implies that a board lacking cybersecurity expertise will face investor inquiries.

For many companies, this call for increased cybersecurity expertise on boards may represent a significant shift. In introducing the bill, the senators referenced a 2016-17 National Association of Corporate Directors Public Governance Survey that found that only 19 percent of respondents believed their boards possessed a high level of cybersecurity knowledge, and 59 percent of respondents found it challenging to oversee cyber risk.[3]

Senator Reed asked Clayton whether he would "be sympathetic" to the legislation's requirements. Without endorsing any particular legislative proposal, Clayton reiterated his belief that cybersecurity disclosures are currently inconsistent, and agreed that informed cybersecurity oversight at the board level would be relevant to investors.

Guidance on 'Materiality' of Risks

During his Senate testimony, Clayton was also asked about SEC guidance on the materiality of cybersecurity risks. The SEC has refrained from issuing additional cybersecurity disclosure guidance since 2011, when its Division of Corporate Finance released guidance on disclosing cybersecurity risks and incidents to investors.[4] The guidance acknowledged that public companies are not explicitly required to disclose cyber risks and incidents, but noted that certain disclosure requirements "may impose an obligation" for such disclosure. Those obligations may include situations where cybersecurity factors are "among the most significant" in making the investment risky, or where they materially affect the company's operations or financial condition.

This "materiality" test allows companies to decide whether a data breach is material enough to warrant SEC disclosure. Perhaps unsurprisingly, a 2016 Audit Analytics study of SEC filings revealed that only 95 of the approximately 9,000 publicly listed companies have informed the SEC of a data breach since January 2010.[5] It appears that many public companies thus do not disclose breaches that may adversely affect their financial performance, based on their own determination that the breach is immaterial to an investor's decision to purchase the company's stock.

Although Clayton emphasized that materiality remains the "touchstone" for evaluating whether to disclose information to an investor, he did not commit to issuing any additional guidance or offer an alternative path (legislative or regulatory) to address disclosures. Absent further guidance, companies may have limited information to help guide what is ultimately a very subjective determination about which attacks are material—a concern that is compounded for companies that face constant attacks and attempted breaches.

Enforcement Activity

Despite the limited number of cybersecurity disclosures, the SEC has yet to bring a formal enforcement action against a company for failure to disclose cyber incidents and risks. Recent statements from the Enforcement Division, however, make clear that the Commission has not ruled out doing so. Speaking at the International Association of Privacy Professionals' Global Privacy Summit in April, acting Enforcement Director Stephanie Avakian said she "absolutely" saw circumstances where the SEC would bring an enforcement action for inadequate disclosures either before or after a data breach.[6] Avakian explained that the SEC was not interested in second-guessing a company's good-faith disclosure decision or "looking for a slip on the banana peel," but would instead focus on significant disclosure failures.

The SEC's continued evaluation of what constitutes a significant failure is worth watching under Clayton, who testified that he has "every confidence" that the Enforcement Division will continue to drive the SEC's enforcement activity. Members of Congress may also increase pressure on the agency to take more aggressive enforcement steps. For example, in the wake of Yahoo's disclosure last year of a data breach affecting 500 million user accounts in 2014, Sen.

Warner requested that then-Chair Mary Joe White "investigate whether Yahoo and its senior executives fulfilled their obligations to keep investors and the public informed."[7]

Before the SEC can meaningfully step-up enforcement, it may have to first confront whether clarified or additional guidance is necessary on the materiality standard. Additionally, the SEC could explore alternative approaches to improve understanding among public companies about when and under what circumstances disclosure is required—such as technical assistance and educational campaigns. A direct move to an aggressive enforcement posture absent such steps could have perverse results: Companies might find themselves with the incentive to over-disclose, leaving investors confused and unable to sort meaningful risks and events from less significant cyber incidents. In the short term, more guidance, and less enforcement, will help companies better navigate materiality determinations.

Conclusion

It remains to be seen how aggressive Clayton's SEC will be in enforcing cybersecurity disclosures. During a panel at the Global Privacy Summit, Fort Worth Regional Director Shamoil Shipchandler said the SEC remains in the "development phase" of cybersecurity enforcement.[8] While it develops those enforcement mechanisms, the SEC has been willing to pursue cases under other parts of its cybersecurity authority, including the "Safeguards Rule," which requires registered broker-dealers, investment companies, and investment advisers to adopt written procedures reasonably designed to protect customer data.

When Clayton wrote, as a private practitioner, that "the world is in the early stages" of coming to terms with cybersecurity and "[n]ow is the time to become wiser," it was June 2015, and his ascent to the SEC was nowhere on the horizon. Now that he has a high-profile platform for raising awareness—and for requiring public companies to own up to these risks—it remains to be seen how aggressively Clayton will push for increased disclosure and enforcement. But, as he put it then, "[i]t is obvious which way the wind is blowing."

Endnotes:

1. Jay Clayton, David Lawrence & Frances Townsend, "We Don't Need a Crisis to Act Unitedly Against Cyber Threats," Knowledge@Wharton (June 2015).

2. Senate Committee on Banking, Housing and Urban Affairs Hearing on the Nomination of Jay Clayton to be a Member of the Securities and Exchange Commission, March 23, 2017.

3. See Warner Introduces Legislation to Bolster Cybersecurity at Publicly-Traded Companies, Press Release.

4. SEC Division of Corporation Finance, CF Disclosure Guidance: Topic No. 2, Cybersecurity, Oct. 13, 2011.

5. "Corporate Judgment Call: When to Disclose You've Been Hacked," The Wall Street Journal (Sept. 19, 2016).

6. "SEC Suits Over Cyber Reporting Could Be on Horizon," Law360, April 20, 2017.

7. See Sen. Warner Calls on SEC to Investigate Disclosure of Yahoo Breach, Press Release.

8. Id.

Danielle C. Gray, a former White House lawyer and Cabinet Secretary to President Obama, is a partner at O'Melveny & Myers in New York and a founding member of the firm's data security and privacy practice. Litigator Patrick D. McKegney is a counsel in the firm's securities litigation group.

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WOODRUFF SAWYER & COMPANY

WS&Co. Blog

July 26, 2016

D&O NOTEBOOK

Do In-House Lawyers Need Insurance Coverage for Malpractice?

By Priya Cherian Huskins

If you serve as in-house counsel, you may have wondered if you need to purchase insurance in case you are sued for malpractice during the course of your duties at your place of employment.

It's a good question, and it's worth taking a moment to separate fact from fiction. In this blog, I'll address California specifically. If you are working elsewhere, this blog post will provide you with a framework that you can use to consider the issues, but you will want to explore the law of the state where you are employed.

Employed lawyers professional liability insurance is a product that responds when an in-house lawyer—think general counsel or a staff employee—is accused of malpractice. But being sued for malpractice as an employee is rare.

As a practical matter, employers don't sue their in-house attorneys for malpractice; they just fire them. But that begs the question: What if they fire you and then want to sue you?

Unlikely.

California Labor Code Section 2802[1] says that employers must indemnify employees for losses incurred as part of their job function:

> *2802. (a) An employer shall indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying the directions, believed them to be unlawful...*

In other words, if your California employer sued you, they might have to turn around and indemnify you. If you are not in California, you may want to check to see if your controlling state labor code offers similar protection.

As an added layer of protection, many senior attorneys negotiate for indemnifications agreements with their

(continued on page 2)

[1] *http://www.leginfo.ca.gov/cgi-bin/displaycode?section=lab&group=02001-03000&file=2800-2810.5*

employers. These agreements are designed to advance legal fees and pay settlements if an indemnitee is sued for something that happened in the course of his or her duties.

Thus, in the event a corporation sues you, you might turn right around and ask for your legal fees to be advanced pursuant to your pre-negotiated indemnification agreement[2].

In California there *is* a technicality that can arise[3] with indemnification agreements that's worth noting. Professional Conduct Rule 3-400[4] prohibits a member of the State Bar of California from contracting with a client to limit liability to the client for malpractice. And, of course, in-house counsel's only client is the corporation that employs them.

As far as we know, this potential conflict has not been resolved. On the other hand, it's common practice today for general counsel to request and receive an indemnification agreement from the company just like any other officer would.

In addition, Delaware General Corporations Code Section 145[5] provides indemnification for agents of Delaware corporations. A similar framework for indemnification exists in California under California Corporations Code Section 317.

Use Cases for Employed Lawyers Insurance

In light of all this, employed lawyers insurance is probably not useful for the main worry expressed by in-house attorneys, that their employers will sue them for malpractice.

So when is employed lawyers insurance useful?

Employed lawyers insurance can be useful when:

A) Someone other than the employer perceives that he has an attorney-client relationship with you and he sues you for malpractice. For example, in the course of your day-to-day dealings with other employees, someone casually asks a question about whether he should exercise his options, or about a speeding ticket or an apartment eviction. If this person now perceives that you are his lawyer because of that exchange, it's possible that he could sue you for malpractice.

Employed lawyers insurance gives an extra layer of protection here, but it's certainly better *not* to casually give advice to folks who are not your clients. Your best practice is to be very deliberate about not giving legal advice to those with whom you do not want to have an attorney-client relationship.

If you're in a work environment where, as a cultural matter, you feel obligated to answer these types of questions, employed lawyers insurance is something you might consider. The same is true if part of your job is to give advice to third parties that are not technically the same as your employer, for example the charitable trust "arm" of your employer.

B) Employers sometimes encourage their employees to moonlight on a pro bono basis. Employed lawyers insurance responds if you are sued for malpractice as a result of these activities. The insurance will provide your defense costs should you find yourself the subject of a hearing in front of the California Bar.

C) You may work for an employer whom you perceive will not defend you if a third party (like a vendor or customer, for example) decides to sue you for legal malpractice for whatever reason, or you are worried that your company might be insolvent[6] (and thus can't indemnify you) at the time of the suit.

How It Works

Employed lawyers insurance can cover the general counsel of a company, other staff attorneys and, in some cases, legal assistants and paralegals acting under the supervision of an in-house attorney. Some policies cover attorneys who are not employed by a company but who are acting on behalf of the company pursuant to a written agreement.

Typical limits for employed lawyers policies range from $1 million to $5 million. The limit a company will purchase depends on factors like the risk tolerance of the company, number of employed lawyers on staff, and the nature of the legal services provided.

(continued on page 3)

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[2] https://wsandco.com/do-notebook/personal-indemnification-before/
[3] https://wsandco.com/articles-updates/articles-updates-2007-5/
[4] http://rules.calbar.ca.gov/Rules/RulesofProfessionalConduct/CurrentRules/Rule3400.aspx
[5] http://delcode.delaware.gov/title8/c001/sc04/
[6] https://wsandco.com/do-notebook/a-guide-to-weathering-corporate-bankruptcy-for-directors-and-officers/

The policy usually covers:

- All claims made against employed lawyers (unless specifically excluded) that arise out of the performance of or alleged failure to perform legal services for the employer
- Legal fees and expenses incurred in defense of employed lawyers accused of legal malpractice
- Amounts paid in damages or settlements in some cases
- Punitive damages with "most favorable jurisdiction" language (with some insurers)

Some typical exclusions are as follows, though many can be negotiated away or are no longer a problem on more modern forms:

- Securities claims (some carriers will give back this coverage for additional premium)
- Professional liability other than for legal services or professional legal liability for services taken other than at the direction of corporate counsel
- Employment practices claims against the employer (some policies can include coverage for claims made against employed lawyers by current or former directors, officers or employees)
- Other applicable insurance (such as D&O insurance)
- Fines, penalties, punitive or exemplary damages
- Trade secret misappropriation
- ERISA (and related acts) violations
- Bodily injury, emotional distress and property damage
- Pollution liability
- Prior acts, prior knowledge or prior notice of a claim or circumstance before a policy's inception date
- Prior and pending litigation
- Wrongful acts committed prior to the retroactive date (including interrelated wrongful acts)

Another typical exclusion is the insured vs. insured[7] clause, which refers to claims against general counsel by another insured person or employer. Some policies carve back the exclusion to provide coverage for claims brought against the employed lawyer by past or present directors and officers.

Another typical carve back to this exclusion is the provision of defense costs for claims brought by the employer against its in-house counsel.

A Good Choice for Some, But Not All

In sum, there are some in-house lawyers for whom employed lawyers insurance makes sense. Each in-house legal department is different. The risks faced by in-house attorneys depend greatly on how an in-house legal department is structured and what specifically the in-house attorneys do. You'll want to work with your trusted advisors to determine whether or not, in your specific case, purchasing employed lawyers insurance is a prudent choice.

When analyzing whether or not to purchase an employed lawyers policy, a good first step is to assess carefully the structure and functions of your in-house legal department.

After that, work with your trusted insurance broker to understand the nuances of what an employed lawyers insurance policy does and does not cover. This will put you in the best position to determine if an employed lawyers insurance policy is right for you.

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[7] *https://wsandco.com/industry-matters/vc-sue/*

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Priya Cherian Huskins can be reached at 415.402.6527 or phuskins@wsandco.com.

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About Priya Cherian Huskins, Esq.

Priya is a senior vice president and partner at Woodruff-Sawyer, one of the largest independent insurance brokerage & consulting firms in the US. She consults with clients on D&O insurance, corporate governance, and ways to reduce their exposure to shareholder lawsuits and regulatory investigations.

Priya is a frequent speaker on D&O issues and a guest lecturer at Stanford's Directors' College. She's on the board of directors of an S&P 500 company, a mature private company, and a FinTech start-up. She's also on the board of the Silicon Valley Directors' Exchange (SVDX) and the advisory board of the Stanford Rock Center for Corporate Governance.

A former corporate and securities attorney at Wilson Sonsini Goodrich & Rosati, Priya has worked with public and private companies through all stages, including IPOs and M&A transactions.

To learn more, contact Woodruff-Sawyer at 844.WSANDCO (844.972.6326), or Priya Cherian Huskins at 415.402.6527 or phuskins@wsandco.com.

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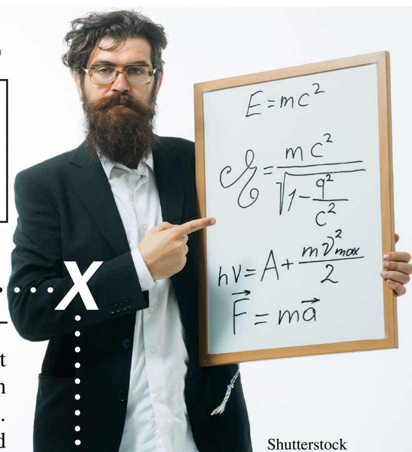
PERSPECTIVE

ART OF THE TRIAL

Experts

By Douglas J. Dixon



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Most trials today involve expert witnesses, and they can often make or break your case. The best expert witnesses are good communicators who can credibly explain and simplify complex, technical evidence and connect with jurors. The worst come across as arrogant, combative hired guns who bore and confuse jurors. So how can you retain the former, and avoid the latter?

Here are some considerations to keep in mind when selecting and retaining testifying experts.

Does the expert have too much testifying experience? Jurors could perceive an expert with extensive experience as a hired gun willing to say anything for a price.

Do I need an expert?

Does your case involve the interpretation of scientific or technical facts or data — e.g., did an alleged false statement cause a company's stock price to be artificially inflated? Does liability or the extent of harm turn on a particular scientific or technical analysis — e.g., does a product infringe a patent? Is the calculation of damages subject to dispute or more than a matter of simple arithmetic? Do your fact witnesses use a lot of technical jargon in answering your questions?

If the answer to any of these questions is "yes," you probably need a testifying expert.

The use of experts at trial is not without limits. In federal court, an expert witness may testify only if his or her testimony will "help the trier of fact to understand the evidence or determine a fact in issue." Fed. R. Evid. 702. Experts may not testify about matters within the "common knowledge" of the jurors. So if it's a question of whether the doctor amputated the left leg when it was the right that should've been amputated, you can't call an expert to explain the difference between left and right. But if it's a question of whether the leg should've been amputated at all, that's where expert testimony is appropriate.

When should I start looking for experts?

As soon as possible. Starting your search early has several advantages — the pool of potential experts will be bigger and your opponent is less likely to be able to lock up the best experts. And once retained, you can — and should — take advantage of your expert's advice on topics ranging from the direction and development of discovery to the identification of case themes and key concepts to potential settlement value. In addition, early retention ensures that the expert has sufficient time to uncover and consider the most important evidence and data that will allow him or her to develop the most effective opinion.

How do I find potential experts?

In some cases, your expert may have been chosen for you. It's the engineer who designed the car's brakes or the doctor who treated the patient's injuries.

More often, however, you have a choice.

Start by drawing upon your own experience and that of your client. Are there any experts with whom you or your client has worked in the past that you might use again? Turn to colleagues inside and outside your firm for recommendations. Scour the biographies and CVs of academics in the relevant field and authors of relevant publications. Consulting firms and expert search firms may also be helpful in locating potential experts. The dockets of cases involving issues similar to yours may also be useful.

How do I choose the best expert?

Here are six things to keep in mind:

Knowledgeable? Jurors are impressed by degrees from well-known academic institutions, but actual hands-on experience is also important. Who can forget the scene from "My Cousin Vinny" when attorney Vinny Gambini called his unsuspecting fiancée Mona Lisa Vito to the stand to testify as an expert in "general automotive knowledge." After conducting a brief voir dire — pronounced *vwahr die-yer* in the movie — that focused on Mona Lisa's automotive experience, the prosecutor withdrew his objection to Mona Lisa, and the judge permitted her to testify as an expert to a noticeably impressed jury. Investigate whether the expert has firsthand experience with the relevant field and issues in your case. The more specific the experience the better.

Experienced? Does the expert have prior testifying experience? It can take time to develop the skills necessary to become an effective testifying expert, and there's no substitute for experience. But, every expert witness has to start somewhere, and sometimes the best expert might be someone with the right set of expertise and skills — and a desire to learn — even if he or she has no prior testifying experience. You should also ask: Does the expert have *too much* testifying experience? Jurors could perceive an expert with extensive experience as a hired gun willing to say anything for a price.

Available? The best experts aren't always available. You and the expert should run conflict checks to ensure that the expert isn't working for your opponent or opposite your client in another case. Make sure the expert has adequate time and interest to devote to your case. Good experts often come at a high cost, so make sure that the expert's fees don't render him or her beyond your reach. Finally, many cases involve protective orders that may place limits on what an expert can do after accessing confidential information — e.g., prosecution bars in patent cases — so make sure your expert is willing to sign and abide by the terms of the protective order.

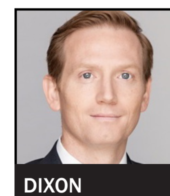
Impartial? Always review an expert's prior experience to ensure that he or she won't be susceptible to claims of bias. Does the expert seem to favor the plaintiff or the defendant? Does the expert always reach the same conclusion on a particular issue — e.g., the asserted patent is invalid or a manufacturing defect existed? Has the expert worked too frequently for your client or your firm?

Good communicator? Jurors pay more attention to an expert's ability to communicate than almost anything else. Expert witnesses should be articulate, confident (but not overly so), dynamic, poised, and unflappable. To find out if your expert possesses these qualities, investigate whether the expert has won any teaching awards, search YouTube for videos of your expert teaching or presenting, and perhaps most importantly, interview the expert, preferably in person. I once asked an expert I was interviewing what he liked least about expert witness work. His response immediately disqualified him: He said, "testifying"! At least he was honest.

Red flags? Evaluate whether your expert's credibility with jurors is susceptible to criticism for reasons unrelated to your case. Always run a background check on any expert you're considering. Confirm the credentials and degrees listed on the expert's CV. I've come across experts who claimed to have degrees for which they never completed the coursework. Research whether any court or tribunal has excluded or critiqued the expert's analysis or testimony, and check whether the expert has offered opinions in prior litigation that are at odds with your position. Call the expert's references, particularly those who have worked with the expert most recently. Finally, during the interview with the expert, ask whom he or she would recommend as an expert if he or she were unavailable. Not only is this a good way to discover other potential experts, but if the expert does not identify anyone else, it's a sign that he or she may lack confidence.

Successful trial lawyers not only have a thorough grounding in the applicable law governing experts, they know how to determine whether they need an expert, how to find the best expert, and perhaps most importantly, how jurors perceive experts. It's the unique alchemy of an impartial mind, rigorous intellect, and honest demeanor that will bring testimony to life, bolster your evidence and yes, help make your case.

Douglas J. Dixon *is a partner in Hueston Hennigan LLP's Newport Beach office.*



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