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THE ROPES RECAP

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IN THIS ISSUE

- NOTEWORTHY DEAL LITIGATION.................... 2
- OTHER KEY DECISIONS 6
- IMPORTANT M&A DEVELOPMENTS............... 10
- TAX UPDATE 11
- SEC UPDATE.. 13
- ASIA UPDATE... 14
- SIGNIFICANT TRANSACTIONS 16
- CONTRIBUTORS 18

WELCOME TO THE ROPES RECAP OF THE FIRST HALF OF 2019

FOLLOWING A STRONG YEAR, general consensus at the end of 2018 was that M&A activity in 2019 would slow down, if not come to a screeching halt. The headwinds certainly appeared to be against us, as going into the year and throughout the first half, we have seen a prolonged government shutdown in the United States, multiple failed Brexit deals, impact from implementation of heightened CFIUS standards and FIRMMA, renewed vigorous antitrust enforcement, and increasingly protectionist U.S. trade policies possibly leading to a full-fledged trade war. Individually, any of these factors could slow us down, but together....

That said, what we've seen is something entirely different. While activity has slowed at some levels of the market, overall deal value is up. Record amounts of "dry powder" among financial sponsors, and heightened shareholder activism have, among other factors, contributed to still vibrant activity at the upper end of the middle market and higher. Economic and political uncertainty continues to cloud the horizon, leading to a challenging M&A environment, but deals are getting done.

Of course, trends in M&A activity do not necessarily translate to activity from the courts. While the first half of 2019 saw several interesting decisions from the courts, the impact doesn't compare to 2018's holdings, including *Akorn v. Fresenius*. This edition does, however, detail some of the more noteworthy ones.

For example, in *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.*, the court found that the contractual right to terminate a merger agreement and the methods by which it could be extended were heavily negotiated deal terms, and the court was not inclined to rewrite the parties' deal when one party inadvertently missed the deadline for a notice requirement. In *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, the Delaware Supreme Court clarified the extent to which stock trading prices can be used to determine fair value by rejecting the Court of Chancery's reliance on the target company's pre-announcement 30-day average stock price (which was well below the deal price) without any incorporation of a deal-price-minus-synergies valuation. Furthermore, in *Goggin v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, the Delaware Superior Court denied two former directors' claim for coverage under a D&O insurance policy. This decision found the language of the policy's "capacity" exclusion to be clear and unambiguous, and the carrier was off the hook.

Outside of Delaware, in *Strougo v. Ocean Shore Holding Co.*, the first published New Jersey state court opinion addressing the *Trulia* standard, the NJ Chancery Division generally followed *Trulia* in holding that disclosure-only settlements are to be subject to "more exacting scrutiny," but signaled that New Jersey courts may take a more accommodating approach to disclosure-only settlements than Delaware courts.

Beyond the courts, the first half of 2019 saw (i) Delaware enact amendments to further modernize the Delaware General Corporation Law, (ii) the FTC increase the HSR size-of-transaction test to $90 million, (iii) the IRS suspend prior guidance limiting tax-free spinoffs, (iv) China adopt a new Foreign Investment Law relaxing some restrictions of foreign investments, and (v) the SEC propose amendments to improve the financial information that investors receive when a registrant acquires or disposes of a business. Each of these is discussed in this edition.

Here at Ropes & Gray, as you can see on the back pages, our dealmakers were busy, handling over $44 billion in transactions over the first half of 2019. As always, we enjoy interacting with our clients and encourage you to reach out to any member of your Ropes team with any questions regarding the contents of this Ropes Recap or any other M&A legal developments of interest to you.

We look forward to continuing to bring you M&A news, trends and legal developments in the future. Thank you.

Ropes Recap Editors

In Delaware, Notices and Deadlines Matter

THE DELAWARE COURT OF CHANCERY decision by Vice Chancellor Glasscock in *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.*, arising from the $1 billion-plus proposed acquisition of Rent-A-Center by Vintage Capital, illustrates that merger partners should not assume that anything less than strict compliance with notice requirements (particularly when they relate to termination rights) and deadlines in a merger agreement will be effective.

In the transaction, because the merger partners anticipated an extended antitrust review, the merger agreement set the end date at six months, with each party having the unilateral right to extend the end date in certain circumstances by another three months, but only, in each case, if such party delivered a written notice to the other party of its election to extend prior to the then-current end date. If neither party elected to extend the end date, either party then had the right to terminate the merger agreement by providing notice of termination.

Between signing of the merger agreement and the initial six-month end date, Rent-A-Center's business improved such that Rent-A-Center's board of directors no longer found the merger to be in the best interests of its stockholders. When the six-month end date passed and Vintage Capital failed to provide the requisite extension notice, Rent-A-Center delivered a termination notice to Vintage Capital early the next day with a demand for payment of the negotiated reverse termination fee. Vintage Capital disputed the termination notice as a "brazen example" of seller's remorse and commenced litigation in the Delaware Court of Chancery seeking (among other things) an order that the merger agreement was still in force.

Vice Chancellor Glasscock rejected Vintage Capital's arguments and was left with the "startling conclusion" that Vintage Capital had simply forgotten to provide the extension notice by the required deadline. This lapse had significant consequences: It allowed Rent-A-Center to escape the transaction and exposed Vintage Capital to a potential reverse termination fee of $126.5 million. Indeed, Rent-A-Center will receive a $92.5 million payment in settlement of this dispute.

Rent-A-Center is a reminder to deal participants to scrupulously comply with their obligations under the governing transaction documents. Too often deal participants are too casual with obligations, sometimes with the erroneous belief that they would find relief in the courts if failure to strictly comply with contractual requirements were to occur. *Rent-A-Center* is a wake-up call in that regard.

***Rent-A-Center* is a reminder**
to deal participants to scrupulously comply with their obligations under the governing transaction documents.

Rent-A-Center is also a cautionary tale of why one merger partner should never assume that the other merger partner still wants to do the deal as much as it does. A remorseful buyer or seller may seek any avenue out of the deal. This "sharp practice," which is how the court characterized Rent-A-Center's actions, was enabled by one party's failure to follow the strict requirements of the merger agreement.

Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc., C.A. No. 2018-0928-SG (Del. Ch. Mar. 14, 2019).

Court of Chancery Upholds Sellers' Claim of Privilege Regarding Pre-Merger Emails

IN *SHAREHOLDER REPRESENTATIVE SERVICES LLC V. RSI HOLDCO, LLC,* the Delaware Court of Chancery upheld a provision in a private company merger agreement that barred the buyer from using the acquired company's privileged pre-merger attorney-client communications in post-closing litigation against the sellers.

The litigation arose from the parties' dispute over certain purchase price adjustments contained in their 2016 merger agreement, pursuant to which RSI Holdco, LLC, an affiliate of private equity firm TA Associates, acquired Radixx Solutions International, Inc., a private company that provides cloud-based services to airlines, for approximately $86.4 million at closing. The sellers' representative, Shareholder Representative Services LLC, commenced the litigation against RSI, claiming that the buyer had breached the merger agreement by failing to repay a $9 million holdback, which was withheld from the purchase price at closing. RSI responded with counterclaims for unjust enrichment and fraudulent inducement against the sellers and sought to use over 1,000 pre-merger emails between Radixx and its legal counsel, which RSI had obtained in connection with the merger, in this litigation.

> **The *RSI Holdco* decision** demonstrates the importance of specifically addressing pre-merger attorney-client communications in the merger agreement and the ownership of the privilege over those communications in situations where the parties wish to contract around the default rules.

In *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP* (previously discussed in our 2013 fourth quarter Ropes Recap, available here), then-Chancellor Strine held that under Delaware law, unless otherwise agreed, the surviving corporation in a merger succeeds to all rights and privileges, including attorney-client privileges, of the constituent corporations. In *Great Hill,* the court noted that parties can "use their contractual freedom…to exclude from the transferred assets the attorney-client communications they wish to retain as their own."

Unlike the sellers in *Great Hill,* Radixx had negotiated a provision in the merger agreement that specifically provided that certain pre-merger communications between Radixx and its legal counsel were privileged, assigned control of the privilege to the sellers' representative, required the sellers and buyer to take steps necessary to ensure that the privilege remained in effect, and prohibited the buyer from using such privileged communications in any litigation against the sellers following the closing. In *RSI Holdco,* the court rejected RSI's argument that the sellers waived their privilege by, among other things, failing to take any action to segregate their privileged communications from the computers and email servers transferred to the surviving company. The court noted that the provision required *all parties* to take any steps necessary to preserve the privilege after the closing and explained that "…for privilege to be waived, it would necessarily be due in part to [RSI's] own failure to 'take the steps necessary' to preserve it. [RSI] cannot argue that its own failure to preserve privilege should now inure to its benefit."

The *RSI Holdco* decision demonstrates the importance of specifically addressing pre-merger attorney-client communications in the merger agreement and the ownership of the privilege over those communications in situations where the parties wish to contract around the default rules.

S'holder Representative Services LLC v. RSI Holdco, LLC, C.A. No. 2018-0517-KSJM (Del. Ch. May 29, 2019).

Delaware Supreme Court Reaffirms Importance of Deal Price in Appraisal Litigation

IN *VERITION PARTNERS MASTER FUND LTD. V. ARUBA NETWORKS, INC.,* the Delaware Supreme Court again endorsed deal-price-minus-synergies as a foundational method for valuing companies in statutory appraisal proceedings. The Supreme Court also rejected the Court of Chancery's total reliance on the target company's 30-day average unaffected stock price, without any incorporation of a deal-price-minus-synergies valuation. The Court of Chancery had determined that the fair value of the acquired company, Aruba Networks, Inc., was $17.13 per share (i.e., the 30-day average unaffected stock price), well below the $24.67 deal price. The Supreme Court unanimously reversed the trial court, holding that Aruba's fair value was instead equal to the deal price after subtracting synergies, or $19.10 per share.

Despite the fact that the Delaware Supreme Court's valuation of Aruba exceeded that of the trial court's, its decision nonetheless confirms the centrality of market-based evidence of fair value—especially based on the deal price (backing out synergies, as required by the appraisal statute)—in appraisal proceedings. *Aruba,* like the Supreme Court's decisions in *Dell* and *DFC*, confirms that, when an efficient market or an arm's-length deal generates evidence of a company's fair value, that evidence must be given significant weight. The decision also underscores the continued risk faced by appraisal petitioners of receiving appraisal awards below, and in some instances well below, the deal price.

The proceedings stemmed from the 2015 acquisition of Aruba by Hewlett-Packard Company for nearly $3 billion. Two funds managed by Verition Fund Management, an appraisal arbitrage hedge fund, sought statutory appraisal rights in respect of shares worth more than $56 million (valued at the deal price). At trial, the petitioners argued—using a discounted cash flow analysis—that their shares were worth $32.57 apiece, a premium of 32% above the deal price. Aruba countered that the company should be valued using the deal price less the value of the synergies created by the merger that were incorporated into the deal price. According to Aruba, that methodology—backing out per-share value attributable to synergies of $5.57—led to a valuation of $19.10 per share. However, in supplemental post-trial briefing, following the Supreme Court's decisions in *Dell* and *DFC* (which encouraged the trial court to give significant weight in appraisal proceedings to reliable market-based evidence of a company's fair value), Aruba jettisoned its prior approach and argued that the company should instead be valued based on the thirty-day average unaffected trading price of its shares, or $17.13 per share. The Court of Chancery agreed that this lower figure was the best evidence of the company's fair value and entered judgment accordingly.

Petitioners appealed, and the Delaware Supreme Court reversed. In a unanimous decision, the Supreme Court principally took issue with the Court of Chancery's perception that a deal-price-minus-synergies valuation fails to account for an additional "element of value derived from the merger itself: the value that the acquirer creates by reducing agency costs." The trial court had reasoned that the deal price reflected Aruba's ability to capture a portion of the value not only of the post-merger synergies that HP expected to realize, but also of the savings HP expected to achieve by consolidating the ownership and management of Aruba. Accordingly, the trial court believed that it needed to account for both synergies *and* expected agency cost reductions to arrive at Aruba's fair value. The Supreme Court disagreed, holding that this methodology was unsupported by the record and, specifically, that there was no basis for concluding that any savings from reduced agency costs were not already accounted for in the calculated synergies.

The Delaware Supreme Court also disagreed with what it viewed as the trial court's urge to treat the unaffected market price of a company's stock as automatically the best evidence of a company's fair value. Clarifying its holdings in *Dell* and *DFC*, the Supreme Court explained that, although the unaffected market price of a company's stock in an efficient market "is an important indicator of its economic value that should be given weight," stock price does not "invariably reflect[] the company's fair value in an appraisal."

The Delaware Supreme Court identified a number of reasons why that was so in the case of Aruba. For example, the appraisal statute requires that acquired companies be valued as of the date of the closing of the transaction, but the time period used by the Court of Chancery to derive Aruba's unaffected stock price was—as it must be in all transactions featuring a lag between public knowledge of the deal and closing—earlier than the transaction's closing date, in this case several months earlier. Thus, the Supreme Court reasoned, the unaffected stock price from that earlier period did not reflect Aruba's developments subsequent to news of the deal breaking, including a favorable earnings report that resulted in a bump in the company's stock price. Additionally, the deal price reflected the fact that HP, as the acquirer, had access to material non-public information about Aruba's prospects, which gave it an informational advantage over the market. The Supreme Court observed that Aruba's argument that its unaffected stock price was the best measure of fair value was "never subjected to the crucible of pretrial discovery, expert depositions, cross-expert rebuttal, expert testimony at trial, and cross-examination at trial." The Supreme Court also made clear that deal-price-less-synergies is an appropriate measure of fair value even where a sales process produces only a single bidder. For these reasons, the Supreme Court concluded that the transaction price for Aruba (minus synergies) was a better measure of fair value than its unaffected stock price.

Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., C.A. No. 11448-VCL (Del. Apr. 16, 2019) (per curiam).

Court of Chancery Declines to Apply *Corwin* Doctrine

In *Chester County Employees' Retirement Fund v. KCG Holdings, Inc.*, the Delaware Court of Chancery refused to apply the *Corwin* doctrine in the sale of KCG Holdings, Inc. to Virtu Financial, Inc., because the stockholder vote to approve the sale may not have been fully informed. The court also denied motions to dismiss breach of fiduciary duty claims against the board and aiding and abetting claims against Virtu and KCG's largest stockholder, who also acted as KCG's financial advisor.

Plaintiffs alleged that the stockholder and Virtu agreed that Virtu would offer, and the stockholder would support, a price that was less than the full value of KCG, and Virtu would divest a key asset of KCG after the acquisition and retain the stockholder as its financial advisor. Plaintiff further alleged that the board accepted a lower price from Virtu because Virtu offered a generous compensation plan to the company's management team, and that the board permitted the CEO to downwardly revise the company's projections before the board approved the transaction, making the per share price look more attractive.

Although defendants moved to dismiss under *Corwin,* arguing that the transaction was subject to the deferential business judgment standard of review because it was approved by a majority of disinterested stockholders, the plaintiff identified the following three material omissions in the company's proxy statement: (i) information about Virtu's divestiture strategy, (ii) the CEO's initial view that Virtu's per share offer was too low, and (iii) the more optimistic, earlier projections presented during the merger negotiations (and the circumstances related to the downwardly revised projections). The court held that "[i] t is reasonably conceivable that a stockholder would view the omitted facts as material and that the information disclosed is materially misleading." Plaintiff's claims were therefore subject to the *Revlon* standard of review which requires the directors to maximize the sale price, and the court held that the CEO's desire to negotiate compensation with the acquirer prior to agreeing on price placed the interests of management above the interests of the stockholders, which "supports an inference of bad faith."

Although the Delaware Supreme Court's *Corwin* decision has provided significant protection for boards of directors and allowed them to "cleanse" many actions with a stockholder vote, this decision cautions that there are limits to *Corwin*'s application, particularly when the disclosures made to stockholders are lacking or misleading. Boards of directors should be careful to avoid any conflicts of interest and if any do arise, they should be clearly disclosed in any proxy materials.

Chester County Employees' Retirement Fund v. KCG Holdings, Inc., C.A. No. 2017-0421-KSJM (Del. Ch. June 21, 2019)

OTHER **KEY DECISIONS**

Delaware Court Limits D&O Insurance Coverage for Directors' Alleged Misconduct Arising Out of Their Roles as Investors

REPRESENTATIVES OF PRIVATE EQUITY SPONSORS serving as portfolio company directors should be aware of a Delaware Superior Court decision regarding D&O insurance coverage. In *Goggin v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, the court denied the plaintiff directors' motion for judgment on the pleadings. The court ruled that because the underlying allegations of misconduct against the directors "arose out of" their roles as investors—and not their roles as directors—there was no coverage for the directors under the company's D&O insurance policy.

The two plaintiffs, Keith Goggin and Michael Goodwin, were initially investors in U.S. Coal Corporation, before becoming directors in 2009. At the same time that they were appointed directors of U.S. Coal, Goggin and Goodwin formed the first of two investment vehicles (the second of which was formed in December 2011) to engage in debt repurchases and other capital restructuring activities in a purported attempt to reinvigorate the struggling company. Their attempts to revive U.S. Coal were ultimately unsuccessful, and the company's creditors filed a petition for Chapter 7 bankruptcy in 2014.

The following year, the company's unsecured creditors sued Goggin, Goodwin and their investment vehicles, alleging that the investor-directors had breached their fiduciary duties and committed other acts of self-dealing. The creditors claimed that Goggin and Goodwin allegedly schemed to use their investment vehicles to control U.S. Coal and to defraud the company's creditors by entering into agreements that secured Goggin and Goodwin a higher return on investment, a preferred recovery in the event of the company's liquidation, and a loan at a significantly discounted value. Goggin and Goodwin tendered a defense request to U.S. Coal's D&O insurance provider, National Union; however, National Union denied their coverage on the grounds that their alleged misconduct was not solely by reason of their status as the company's directors.

A New Jersey Court Adopts a Different Approach to "Disclosure-Only" Settlements

In the *In re Trulia, Inc. Stockholder Litigation* decision (previously discussed in our 2018 second quarter Ropes Recap, available here), the Delaware Court of Chancery rejected a proposed "disclosure-only" settlement as inadequate. The *Trulia* decision catalyzed a dramatic change in the Court of Chancery's approach to disclosure-only settlements of M&A stockholder litigation. How the *Trulia* decision will affect outcomes in other jurisdictions is beginning to emerge as "disclosure-only" settlements in other states are litigated. For example, while the United States Court of Appeals for the Seventh Circuit held that such settlements are "no better than a racket" and "must end," the New York Court of Appeals has approved "disclosure-only" settlements. Citing *Trulia,* the New Jersey Superior Court Chancery Division in *Struogo v. Ocean Shore Holding Co.* held that class action settlements involving non-monetary benefits to the class are subject to more exacting scrutiny. However, the court nevertheless concluded that the supplemental disclosures provided a material benefit to the class, and the court approved the proposed class action settlement. Notably, the court's analysis did not include a discussion of the scope of claims released on behalf of the class, which was an important factor contributing to Chancellor Bouchard's conclusion that the proposed settlement in *Trulia* was not fair, reasonable and adequate to Trulia's stockholders. The *Struogo* decision signals that New Jersey courts may take a more accommodating approach to disclosure-only settlements than Delaware courts.

Strougo v. Ocean Shore Holding Co., 198 A.3d 309 (2017), approved for publication Jan. 10, 2019.

In denying coverage to Goggin and Goodwin, National Union invoked the policy's "capacity" exclusion, which stated:

> The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an insured…alleging, arising out of, based upon or attributable to any actual or alleged act or omission of an Individual Insured serving in any capacity, other than as an Executive or Employee of a Company….

This decision highlights that directors must review and understand the terms of their company's D&O insurance policy, including the "capacity" exclusion.

The court found the language of the "capacity" exclusion to be clear and unambiguous. Consistent with Delaware law, the court construed "arising out of" broadly and applied a "but for" test to conclude that the alleged misconduct claims against Goggin and Goodwin would not have been established but for Goggin and Goodwin's roles as members/managers of their investment vehicles.

This decision highlights that directors must review and understand the terms of their company's D&O insurance policy, including the "capacity" exclusion. This issue is particularly important for private equity professionals serving as directors of portfolio companies, as they should understand the potential vulnerabilities in insurance coverage and be prepared to address them at the next policy renewal.

Goggin v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., No. N17C-10-083 PRW CCLD (Del. Super. Ct. Nov. 30, 2018).

Delaware Court Issues Injunction Preventing the Sale of Shares

On January 23, 2019, the Delaware Court of Chancery granted a preliminary injunction to prevent the sale of certain shares of Applied Energetics, Inc., noting it was "reasonably probable" that the shares had been invalidly issued. The case serves as a reminder of the importance of obtaining required approvals when issuing stock, and the risk that a share issuance can subsequently be found invalid when appropriate steps to obtain required approvals have not been taken.

In October 2014, after demand for its defense technology slowed, Applied Energetics' three-member board decided to place the company into shell status. While in shell status, Applied Energetics did not pay its directors. Two of the directors subsequently resigned, leaving George Farley as the only remaining director. Farley caused the company to issue 25 million shares of stock to himself at par value ($0.001 per share) as compensation for his services as an officer and director. These shares represented over one-fourth of the company's outstanding shares. Farley subsequently transferred those shares to AnneMarieCo., LLC, which was owned by Farley's wife and six children. After exiting shell status, the company's stockholders ousted Farley. The company filed suit, claiming that Farley had breached his fiduciary duties and that the transfer of shares from Farley to AnneMarieCo. was a fraudulent transfer. The company sought a preliminary injunction to prevent a further sale of the shares held by AnneMarieCo.

In issuing the preliminary injunction, the court noted that there was no evidence of a resolution or other action reducing the size of a quorum for a board meeting or the board's size. The court thus concluded that it was reasonably probable that the shares were invalidly issued, because a valid issuance would have required the affirmative approval of at least two directors.

Applied Energetics, Inc. v. Farley, No. CV 2018-0489-TMR (Del. Ch. Jan. 23, 2019).

Delaware Supreme Court Finds Viable *Caremark* Claim

IN ***MARCHAND V. BARNHILL,*** the Delaware Supreme Court reversed the Court of Chancery's dismissal of claims alleging that the directors of Blue Bell Creameries USA, Inc., one of the country's largest ice cream manufacturers, breached their duty of loyalty under *Caremark*. Under *Caremark,* a director must make a good faith effort to oversee the company's operations. Failing to make that good faith effort breaches the duty of loyalty and can expose a director to liability. The *Marchand* decision serves as an important reminder that, while *Caremark* claims are "difficult to plead and ultimately to prove out," the onerous pleading burden is not impossible to meet. The decision also demonstrates the importance of establishing a reasonable compliance and reporting system for ***board-level*** oversight of a company's operations and legal compliance, including monitoring of key compliance risks. In addition, the opinion offers guidance on the types of personal and business relationships that may support a pleading-stage inference that a director cannot act independently.

In April 2015, Blue Bell recalled all of its products amidst a *listeria* outbreak, which allegedly sickened many people and resulted in three deaths. The outbreak may not have come without warning—the stockholder plaintiff's complaint alleged troubling compliance failures at the company's facilities dating back to 2009. The plaintiff's complaint alleged that, although Blue Bell's management had received reports about *listeria*'s growing presence in Blue Bell's plants, the board never received any information about *listeria* or more generally about food safety issues until the *listeria* outbreak that forced the recall of Blue Bell's products.

With operations shuttered during the recall, Blue Bell was driven into a liquidity crisis during which it accepted a dilutive private equity investment that resulted in losses to stockholders. Based on these events, a stockholder brought a *Caremark* claim against Blue Bell's directors and also alleged that Blue Bell's president and CEO and vice president of operations breached their duties of care and loyalty by knowingly disregarding contamination risks and failing to oversee the safety of the company's food-making operations. In the decision below, the Court of Chancery granted the defendants' motion to dismiss as to both claims.

The crux of the Court of Chancery's reasoning for dismissal of the *Caremark* claim was that the plaintiff was challenging the *effectiveness* of board monitoring and reporting controls rather than the existence of such controls. The Delaware Supreme Court disagreed. According to Chief Justice Strine, the plaintiff's complaint alleged particularized facts to support a reasonable inference that Blue Bell's board of directors failed to meet *Caremark's* "bottom-line requirement" that the board "exercise oversight" by making a good faith effort to put in place a reasonable board-level system of monitoring and reporting. The Supreme Court focused on the fact that ensuring that the only product that the company made—ice cream—was safe to eat was one of the most central issues at the company, and yet, based on the facts alleged in the plaintiff's complaint and reasonable inferences from those facts:

- the Blue Bell board had no committee that addressed food safety;
- there was no regular process or protocols that required management to keep the board apprised of food safety compliance practices, risks, or reports;
- there was no schedule for the board to consider any key food safety risks on a regular basis;
- during a key period leading up to the April 2015 outbreak, management received reports that contained what could be considered red or yellow flag warnings of food safety issues, but the board minutes for the relevant period revealed no evidence that these were disclosed to the board or discussed;
- the board was given certain favorable information about food safety by management, but allegedly was not given important reports that presented a different picture; and
- the board meetings were devoid of any suggestion that there was any regular discussion of food safety issues.

OTHER **KEY DECISIONS** *(continued from page 8)*

The Supreme Court observed that "[i]f *Caremark* means anything, it is that a corporate board must make a good faith effort to exercise its duty of care. A failure to make that effort constitutes a breach of the duty of loyalty." While the defendants argued that Blue Bell had to meet FDA and state regulatory requirements for food safety, that the company had food safety employee manuals in place and commissioned audits from time to time, and that management regularly reported to the board on operational issues, the Supreme Court found these facts insufficient to rationally suggest that Blue Bell's board had implemented a reporting system to monitor food safety.

This decision also demonstrates the importance of establishing a reasonable compliance and reporting system for ***board-level*** oversight of a company's operations and legal compliance, including monitoring of key compliance risks.

The Supreme Court also reversed dismissal of the complaint for failure to make a pre-suit demand on the board. In the decision below, the Court of Chancery had ruled that seven directors—one less than a majority—were not independent, but that a majority of the board could impartially consider a demand as to the claims against the Blue Bell executives. However, the Supreme Court noted an eighth director's 28-year career at Blue Bell, in which the director rose from an administrative assistant to the company's CFO and later a member of the company's board, which one could reasonably infer was due to the support of the CEO's family. In addition, a local college named a building after the director, after the CEO's family had led a fundraising campaign that raised over $450,000.

The Supreme Court observed that "deep and long-standing friendships are meaningful to human beings and that any realistic consideration of the question of independence must give weight to these important relationships and their natural effect on the ability of the parties to act impartially toward each other." The Supreme Court thus concluded that the plaintiff's complaint pleaded facts sufficient to support a reasonable inference of "very warm and thick personal ties" between the CEO's family and the director, which created reasonable doubt that that director could act impartially.

Marchand v. Barnhill, C.A. No. 2017-0586-JRS (Del. June 18, 2019).

Delaware Enacts Amendments to Modernize the Delaware General Corporation Law

IN JUNE 2019, Delaware Governor John Carney signed Senate Bill No. 88, which amends the Delaware General Corporation Law (DGCL) by, among other things, (i) adding new provisions relating to the documentation of transactions and the execution and delivery of documents, including by electronic means, (ii) revising the default provisions applicable to notices to stockholders under the DGCL, the certificate of incorporation or the bylaws, including by providing that notices may be delivered by email, except to stockholders who expressly "opt out," and (iii) clarifying that an action taken by the unanimous consent of directors in lieu of a meeting may be treated as taken before the consents relating to the action are filed in the corporation's minute book. These amendments went into effect on August 1, 2019.

The amendments add a new provision that establishes non-exclusive, safe harbor methods to reduce certain acts or transactions to electronic documents and to permit the signing and delivery of such documents through electronic means. New Section 116(a) provides that, whenever the DGCL or the certificate of incorporation or bylaws requires or permits a signature, the signature may be a manual, facsimile, conformed or "electronic signature," which is defined to mean an electronic symbol or process that is attached to, or logically associated with, a document and executed or adopted by a person with an intent to authenticate or adopt the document.

Of particular significance to M&A practitioners are the amendments to Sections 232 and 262 of the DGCL that will permit a corporation to deliver notices to stockholders by email. As amended, Section 262 will permit a corporation to deliver a notice of appraisal rights with respect to a proposed merger or consolidation by courier or email, instead of delivering the notice by mail. In addition, demands for appraisal may be sent to the corporation by email, but only if the corporation expressly designates in the notice of appraisal rights given by the corporation an information processing system (e.g., an email address) for receipt of the electronic delivery of such demands. Note that these amendments apply to stockholder notices under the DGCL, but do not affect or override the application of any other law or regulation applicable to a corporation (e.g., the federal proxy rules).

FTC Announces Increased HSR Thresholds

In March 2019, the Federal Trade Commission announced the following revised jurisdictional and filing fee thresholds under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, for transactions closing on or after April 3, 2019:

- The $50 million (as adjusted) threshold used in the size-of-transaction test increased from $84.4 million to **$90 million**.
- The $10 million (as adjusted) and $100 million (as adjusted) sales and assets thresholds used in the size-of-persons test increased from $16.9 million to **$18 million** and from $168.8 million to **$180 million**, respectively.
- The $200 million (as adjusted) threshold, below which the size-of-persons test applies, increased from $337.6 million to **$359.9 million**.

The filing fees have not changed (other than the triggering amounts described above). The FTC has also increased the civil penalties for noncompliance with the HSR Act to $42,530 (previously $41,484) for each day during which a person is in violation of the HSR Act. For additional information regarding HSR jurisdictional thresholds and reporting requirements, please contact any member of Ropes & Gray's Antitrust Practice Group.

IRS Suspends Prior Guidance Limiting Tax-Free Spinoffs

ON MARCH 21, 2019, the IRS announced the temporary suspension of two revenue rulings addressing tax-free spinoffs. The suspended rulings had arguably required the distributing corporation and the spun-off corporation to each independently generate current revenue. This development is welcome news for life sciences, technology, and other R&D-focused business organizations that had not previously pursued a tax-free spinoff because of the perceived revenue requirement. This announcement comes on the heels of the IRS's September 2018 announcement (which we discussed in our 2018 third quarter Ropes Recap, available here) that it is prepared to issue favorable rulings on the tax-free treatment of corporate spinoffs by research-intensive business ventures that do not currently collect income, while the IRS studies the issue.

In Revenue Ruling 2019-09, the IRS suspended two prior rulings, each issued in 1957, because the rulings "could be interpreted as requiring income generation for a business to qualify" as an active trade or business. The suspension of the rulings during the pendency of the IRS study is a concrete step by the IRS with immediate impact, upon which taxpayers and their advisors may rely in evaluating whether the spinoff of a historic R&D-based business will qualify for tax-free treatment, or in seeking a private letter ruling from the IRS. For now, at least, the suspension resolves the tension between the suspended rulings and the regulations that adopt a somewhat more liberal approach. While the suspension may not prove permanent, the move provides further evidence that the IRS is prepared to take a more modern approach to the qualification of businesses without revenue as "active trades or businesses."

For a corporate separation to qualify as a tax-free spinoff, both the distributing parent corporation and the spun-off controlled corporation must, among other things, be engaged, immediately after the distribution, in "active trades or businesses" conducted for a minimum of five years. The suspended rulings involved spinoffs of (or by) a business that generated little or no income, a key factor in the conclusion that the active trade or business requirement was not satisfied in the rulings.

One of the suspended rulings involved a petroleum refining, marketing and transport company that began a separate operation to explore for and produce oil. The exploration and production operation incurred substantial expenditures but "did not include any income producing activity or any source of income" until less than five years preceding its separation from the primary refining, transportation, and marketing operation. The IRS stated that an active trade or business "does not include a group of activities which, while part of a business operated for profit, are not themselves independently producing income even though such activities would produce income with the addition of other activities, or with large increases in activities previously incidental or insubstantial." The IRS also observed that if the exploration venture had been discontinued at any time prior to discovery of oil, the corporation would never have been engaged in producing oil. Accordingly, the IRS ruled that the exploration and production activities did not constitute an active trade or business because before the discovery of oil in commercial quantities, the venture "did not include any income producing activity or any source of income."

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 (continued from page 11)

The other suspended ruling considered a corporation's separation of a manufacturing business from a group of real estate assets. The IRS ruled that the company's real estate activities did not qualify as an active trade or business, because only a subset of the properties were rented, and those properties "produced only a nominal rental" and "negligible" net income. Further, the properties "were acquired either as an investment or as a convenience to employees of the manufacturing business."

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Prior to their suspension, both of the above rulings could have been interpreted as significant obstacles to tax-free spinoffs by life sciences, technology, or other businesses that are research-intensive and are not yet collecting income. In some cases, though, those rulings may already have been distinguishable from such spinoffs based on factual differences. Unlike the ruling where the oil exploration activity was an organizationally separate vertical expansion of the refining company's activity, many technology or life sciences spinoffs may involve a separation of similar product lines at various stages of development that may have previously been organizationally integrated. In addition, in contrast to the real estate in the second ruling, a pre-commercial-stage technology or life sciences venture, for example, would not ordinarily have been created or acquired as a convenience to the employees of a business, or as a passive investment that the company had no apparent intent to develop, with its own employees, into an income-producing line of business.

However, the reasoning of both 1957 rulings, especially the first, went beyond the facts described, and was arguably inconsistent with the underlying tax regulations and subsequent IRS guidance. The regulations provide that an active trade or business "*ordinarily* must include the collection of income and the payment of expenses," which suggests that at least some businesses that are not yet collecting income can qualify as an active trade or business. But neither ruling addressed that possibility. Further, the second ruling dropped the key word "ordinarily" and instead stated, "The regulations further indicate that a group of activities, which are not themselves producing income, will not qualify as an 'active business.'" A separate IRS ruling from 1982, which has not been suspended, states, "The use of the word 'ordinarily' in…the regulations indicates that there are exceptional situations where, based upon all the facts and circumstances, there is no concurrent receipt of income and payment of expenses which, nevertheless, will constitute an active trade or business." The 1982 ruling, however, did not cite or distinguish either of the 1957 rulings. The suspension of the two 1957 rulings therefore constitutes a significant and positive development that provides much-needed clarity as to the IRS's position during the pendency of the IRS study.

SEC Proposes Significant Changes to the Financial Disclosure Requirements for Acquisitions and Dispositions of Businesses

ON MAY 3, 2019, the SEC proposed amendments to improve the financial information that investors receive when a registrant acquires or disposes of a business. If adopted, the proposed amendments would significantly reduce the complexity and compliance costs in preparing these financial disclosures.

The proposed amendments would, among other things:

- revise the "investment test" and the "income test" used to determine the significance of an acquisition or disposition, expand the use of pro forma financial information in measuring significance, and apply the same significance threshold and tests for a disposed business;
- require no more than two years of audited financial statements of an acquired business (depending on its relative significance);
- permit abbreviated financial statements of a target business carved out of a broader entity that did not maintain separate financial statements for the target business;
- eliminate the requirement to provide separate acquired business financial statements once the business has been included in the company's post-acquisition financial statements for a complete fiscal year;
- eliminate the "substantial majority" test for "individually insignificant businesses" that in the aggregate exceed 20% and only test significance on an individual basis;
- permit the use of, or reconciliation to, International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) in certain circumstances; and
- amend the pro forma financial information requirements to improve the content and relevance of such information, including with expected synergies from the acquisition.

While the proposed amendments would not apply to financial statements related to the acquisition of a business that is the subject of a proxy statement or registration statement on Form S-4 or Form F-4, they would apply to pro forma information provided pursuant to Article 11 and financial information for acquisitions and dispositions required to be disclosed in the registration statement pursuant to Rule 3-05 or Rule 3-14 of Regulation S-X.

Among the more significant changes are the proposed modifications to the investment and income tests that are applied to determine the significance of a business acquisition or disposition. These proposed changes are intended to assist companies in making more meaningful significance determinations and to reduce anomalous results.

Modifications to the Investment Test. Under current rules, the investment test compares the company's investment in and advances to the acquired business (i.e., the purchase price) to the carrying value of the company's total assets. The proposed amendments would instead require a comparison to the "aggregate worldwide market value" of the company's voting and non-voting common equity, when available. If the company does not have publicly traded common equity, the current investment test would continue to apply. The SEC believes that the use of the company's aggregate worldwide market value would better align the investment test with the economic significance of the acquisition to the company.

Modifications to the Income Test. Under the current rules, the income test uses the acquirer's income from continuing operations ***before*** income taxes. The proposed amendments would add a new revenue component to the comparison and simplify the calculation by using income or loss from continuing operations ***after*** income taxes (which should permit a company to use the line item disclosure from its financial statements). Under the proposed amendments, the income test would require that, where the company and its subsidiaries and the tested subsidiary have recurring annual revenues, the tested subsidiary must exceed the threshold on both the revenue component and the net income component. The lower of the revenue or the income component of the test would be used for purposes of determining the number of years required. Where a company or tested subsidiary does not have recurring annual revenues, only the net income component would apply, and the income test would be revised to calculate net income and average net income using

absolute values. The SEC believes that these changes would allow companies to more accurately determine whether a business is significant to the company and would reduce the frequency of the anomalous result of immaterial acquisitions being deemed significant.

Comments on the rulemaking proposal were due by July 29, 2019.

China Adopts New Foreign Investment Law

BACKGROUND

ON MARCH 15, 2019, the final draft of China's new foreign investment law was approved by the National People's Congress of China (the "Foreign Investment Law"). The Foreign Investment Law will become effective on January 1, 2020 as the primary legislation governing foreign investment in China. It will replace several existing laws, namely the *Wholly Foreign-Owned Enterprises Law* (also known as the *Foreign-Capital Enterprises Law*), the *Sino-Foreign Equity Joint Ventures Law,* and the *Sino-Foreign Contractual Joint Ventures Law,* which governed foreign investment in China in the last few decades.

> **Under the new law,** foreign-invested enterprises will be able to enjoy the benefits of applicable policies that promote the business interests of domestic Chinese enterprises.

A draft of the Foreign Investment Law first came to public view in 2015, but it was not actively discussed until mid-2018 when the U.S.-China trade war intensified. Many legal experts and policy critics believe that the new Foreign Investment Law was brought to the spotlight and rushed into effect by the Chinese government partly to respond to complaints from foreign businesses and governments.

Set forth below are some of the most important changes in the new Foreign Investment Law that are designed to address some common concerns that foreign investors have faced in China.

MAJOR PROVISIONS

NATIONAL TREATMENT

The new law provides that, as a guiding principle, foreign investors will enjoy national treatment (i.e., the treatment of foreigners and locals equally) and compete with domestic enterprises on an equal footing in the PRC domestic market (however, a portion of certain industries such as financial services, transportation, professional services, infrastructure, energy, resources, and agriculture that are listed on the Special Administrative Measures (Negative List) for the Access of Foreign Investment (2018) remain excluded). Under the new law, foreign-invested enterprises will be able to enjoy the benefits of applicable policies that promote the business interests of domestic Chinese enterprises. Products manufactured domestically by foreign-invested enterprises shall be treated on the same basis as those manufactured by domestic Chinese enterprises, and foreign-invested enterprises will also be able to participate in government procurement activities on an equal footing with domestic enterprises.

INTELLECTUAL PROPERTY PROTECTIONS

The lack of intellectual property protection has been a major concern for foreign investors in China. The Special 301 Report published by the U.S. government in 2018 commented that China has adopted "coercive technology transfer practices, a range of impediments to effective IP enforcement, and widespread infringing activity—including trade secret theft, rampant online piracy, and counterfeit manufacturing." The Foreign Investment Law emphasizes the protection of the intellectual property rights of foreign investors and foreign-invested enterprises by prohibiting government interference or coercion and by introducing legal liability for intellectual property infringement. The terms of any technology cooperation agreement in any Sino-foreign joint venture

 (continued from page 14)

shall be determined through fair negotiation between the parties on an arm's-length basis. The guiding principle of this provision will likely need to be implemented through revisions to the relevant intellectual property legislation in China.

- OTHER NOTEWORTHY PROTECTIONS

-Administrative departments and their staff members will be required to keep confidential any business secrets of foreign investors or foreign-invested enterprises that they become aware of during the performance of their duties.

-Foreign investment rules formulated by the local governments shall not illegally (i) impair any rights of, or impose additional obligations on, foreign-invested enterprises; or (ii) impose illegal market access restrictions or exit conditions to influence normal production and operation activities of foreign-invested enterprises.

-A complaint mechanism will be established to protect foreign-invested enterprises to cover the entire lifecycle of foreign investment, from establishment to dissolution.

CONCERNS

Although the Foreign Investment Law is welcomed as a step in the right direction to protect and promote foreign investments and foreign investors' rights in the PRC, the legislation's language is vague and will need to be further clarified through the implementation of regulations with greater specificity. Until then, it remains unclear how the guiding principles under the Foreign Investment Law will be implemented and enforced (and whether they will be implemented in full).

For example, the scope of "foreign investors" and "foreign investment" needs to be further detailed and clarified. Currently, under the Foreign Investment Law, foreign investment refers to any investment activity *directly or indirectly* carried out by foreign natural persons, enterprises or other organizations within the territory of China. However, the term "indirect investment" is not defined. It is unclear if, and to what extent, the investors will be required to disclose their ultimate controlling shareholder in order for the government to determine if it is an indirect foreign investment. The Foreign Investment Law also does not clarify if an investment qualifies as a foreign investment when the ultimate controlling shareholder of a foreign investor is a PRC citizen or a PRC entity. Moreover, while the existing laws in respect of foreign investment cover investments from Taiwan, Hong Kong and Macau, it is ambiguous if the new Foreign Investment Law will still apply to investments from Taiwan, Hong Kong and Macau.

Although the Foreign Investment Law is welcomed as a step in the right direction to protect and promote foreign investments and foreign investors' rights in the PRC, the legislation's language is vague and will need to be further clarified through the implementation of regulations with greater specificity.

In addition, the Foreign Investment Law does not clarify the status and legality of variable interest entities, one of the most common structures used for foreign investments in China (especially in the technology sector) in order to gain access to industries and licenses that prohibit shareholding by foreign investors. It is unclear whether the Chinese government will publish further regulations targeting variable interest entities.

THE ROPES RECAP

SIGNIFICANT **TRANSACTIONS**

CHURCHILL CAPITAL CORP

Represented Clarivate Analytics in its acquisition of Churchill Capital Corp

OGSYSTEMS OWN THE OUTCOME

Represented OGSystems in its sale to Parsons

Ørsted

Represented Eversource Energy in its partnership with Ørsted

Represented Preferred Freezer Services in its sale to Lineage Logistics

Represented Penn Foster in its acquisition of Ashworth College

Represented HaystackID in its acquisition of eTERA Consulting

ZOMEDICA Come full circle.

Represented Qorvo Biotechnologies in its development agreement with Zomedica

Represented Beaver-Vistec International in its acquisition of PhysIOL

BY THE NUMBERS

ROPES & GRAY ACQUISITION TRANSACTIONS—Q1

27 Deals

$21+ Billion in Transactions

10 Cross-Border Deals

5 Countries

12+ Industries

Fred Segal

Represented Fred Segal and its principal owner Evolution Media in Fred Segal's sale

TAVHealth

Represented Signify Health in its acquisition of TAVHealth

metso

Represented Moly-Cop in its acquisition of Metso Grinding Media

MAVIN GLOBAL IT Solutions Made To Empower

Represented Kupanda Holdings in its partnership with Mavin Global

Represented Cirque du Soleil in its acquisition of The Works

U.S. Risk

Represented U.S. Risk Insurance Group in its sale to USI Insurance Services

Represented Innocor in its merger with FXI

DDS DENTURES+IMPLANT SOLUTIONS

Represented Affordable Care in its acquisition of DDS Dentures + Implant Solutions

THE ROPES RECAP

SIGNIFICANT TRANSACTIONS

Represented Wieland-Werke AG in its acquisition of Global Brass and Copper Holdings, Inc.

Represented Alibaba in its investment in Megvii Technology Limited

Represented Acushnet Holdings Corp. in its acquisition of LK International AG

Represented the Flight Centre Group in a strategic investment and commercial agreement with The Upside Travel Company

Represented Alibaba in its acquisition of Teambition

Represented PJT Partners, financial advisor to Caesars Entertainment, in connection with Caesars' merger with Eldorado Resorts

BY THE NUMBERS

ROPES & GRAY ACQUISITION TRANSACTIONS—Q2

57 Deals

$23+ Billion in Transactions

13 Cross-Border Deals

8 Countries

22+ Industries

Represented Qorvo, Inc. in its definitive agreement to acquire Active-Semi International, Inc.

Represented Travel Management Company in its acquisition by Wheels Up

Represented Veracross LLC in its acquisition of Magnus Health, LLC

Represented Storable in its acquisition of StorSmart

Represented Mitsubishi UFJ Trust and Banking Corporation in its acquisition of Point Nine

Represented Backcountry.com in its acquisition of Roanoke Valley Power Sports, L.C. d/b/a Star City Powersports

Represented HealthDrive in its acquisition of New England Geriatrics

Represented LightBox Holdings, L.P. in its acquisition of RealCapitalMarkets.com

Represented Stanadyne Corporation in its acquisition of PurePOWER Technologies

Represented Truck Hero in its acquisition of Lund

THE ROPES RECAP

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