THOMPSON HINE

Business Law Update

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Mergers & Acquisitions

Cross-Border Mergers: Foreign Investment Considerations

By Michael W. Jahnke and Rachel G. Talay

With deals today being larger and more global than ever before, a merger between two U.S. companies may have far-reaching effects in countries around the world. A buyer may now find itself facing foreign investor regulatory hurdles that were rarely an issue for cross-border mergers in the past.

In recent years, the number of countries with "merger control" regulations – essentially, local laws giving national authorities the right to review a transaction to identify potential antitrust or competition concerns – has grown significantly. Approximately 120 countries now have competition laws, with the majority including merger control provisions, necessitating that many cross-border deals undergo relatively detailed jurisdictional analysis to identify possible pitfalls, particularly as to mandatory filings and waiting (or "suspension") periods during which closing cannot occur.

A related dynamic involves the relatively recent growth in the number of countries introducing foreign investment regulations. The United States was arguably a frontrunner in this space by subjecting investments by foreign companies to a national security review. Enacted in 1988, the Exon-Florio Amendment authorizes the president to investigate foreign acquisitions and mergers of, or investments in, U.S. companies from a national security perspective. The president is authorized to prohibit a transaction that appears to threaten national security. The Committee on Foreign Investment in the United States (CFIUS) reviews transactions to aid that determination. Foreign investment filings are typically driven not by antitrust/competition considerations, but instead by a desire to address specific national concerns and sensitivities such as the economy, safety, local policy and national security. Some regulations even go so far as to completely prohibit foreign investment in certain sectors.

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- "Reading the Tea Leaves from the Oral Arguments in the Conflict Minerals Rule Appeal – Should Companies Put Compliance on Hold?" by James A. Losey and Tammy P. Bieber

For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.

The latest country to adopt such regulations is Germany. Under § 7 of the Außenwirtschaftsgesetz (Foreign Trade Act), the Ministry of Economics and Technology (MET) is entitled to review – and eventually restrict or prohibit – foreign investors' acquisition of substantial shareholdings in German companies. Any investment from outside the European Union in 25 percent or more of the shares of a German enterprise, if deemed to potentially threaten Germany's public interest or public security, is subject to review. Acquisitions by investors from within the EU may likewise be examined if one of their shareholders comes from a third country and holds 25 percent or more of the shares.

As in the United States, there is no requirement to notify the MET of most acquisitions, but taking this "voluntary" characteristic too far carries significant risks in a deal considered likely to trigger review. The MET may initiate a review of a foreign investment within three months of the signing of the agreement and, within another two months, may prohibit the acquisition. Stricter rules apply to acquisitions in certain strategic sectors (war weapons, certain cryptographic systems, or specially designed motors or gears for combat tanks and other armored military-tracked vehicles), which must be reported to the MET.

Below is a brief summary of some other countries' foreign investment regulations that might be triggered by a cross-border merger:

Canada

The Investment Canada Act applies whenever a foreign investor directly or indirectly acquires control of a Canadian business regardless of whether it is owned by Canadians or non-Canadians. Factors used to determine whether a notification is required include:

- Whether the investor is a "WTO investor" (i.e., controlled by persons who are citizens of countries that are World Trade Organization members)
- The book value of the acquired business's assets
- Whether the acquired business engages in cultural activities (such as books, magazines, film, television, audio or video recordings, or radio or television broadcasting)

An application for review is made to the Investment Review Division of the federal Department of Industry. The initial review period is 45 days, but it can be extended for an additional 30 days.

The Investment Canada Act also has a national security review regime that can review a transaction potentially injurious to national security, which can be initiated regardless of the investment's value. The national security review regime was designed to align Canada's process with that used by CFIUS in the United States.

China

All foreign investment in China is subject to discretionary approval by China's Ministry of Commerce (MOFCOM). The Rules on Mergers with and Acquisitions of Domestic Enterprises by Foreign Investors require a foreign investment notification to MOFCOM where a transaction will result in a foreign investor obtaining a controlling interest in a Chinese company and where the domestic target operates in a "key industry," the transaction may impact state "economic security," or the domestic target possesses a well-known trademark or established Chinese brand.

China also has a national security review regime that applies to acquisitions of Chinese domestic interests by foreign investors if the transaction involves the military sector, key agricultural products, key energy infrastructure, transport, technology or equipment manufacturing, and the transaction is likely to result in the foreign investor acquiring "actual control" over the Chinese domestic enterprise. The national security review lasts up to 30 working days in phase I and up to 60 working days in phase II. If the reviewing committee cannot reach consensus, there is no time limit for a decision.

Japan

The Foreign Exchange and Foreign Trade Law applies to foreign direct inward investments in Japan, requiring a foreign investor that has made an investment in Japan to make a post-deal filing within 15 days. There are also regulated industries where foreign ownership levels are limited by specific legislation.

Many additional jurisdictions regulate foreign investment or national security, or have special sector-specific regulations addressing foreign investment, including Australia, Austria, Belgium, Brazil, Chile, Egypt, France, Iceland, India, Mexico, Morocco, New Zealand, Russia, Spain, Saudi Arabia and Taiwan. Parties contemplating a merger or acquisition should consult counsel to determine which regulations apply to their specific transaction.

For more information, contact Michael W. Jahnke or Rachel G. Talay.

Licensing

We Just Did a Statutory Conversion: Did We Lose Our Software License?

By John D. Cottingham and Justin D. Tillson

The Sad Story

Picture this: At the behest of your tax department and their advisors, and at the direction of your chief financial officer, you converted one of your operating subsidiaries (Faultless, Inc.) from a Delaware corporation into a Delaware limited liability company (Faultless, LLC). You did your diligence, including verifying that none of Faultless's material contracts contained any prohibitions on, or obligations in connection with the consummation of, a statutory conversion. These are pretty simple transactions and, accordingly, you didn't give it much thought after it was completed.

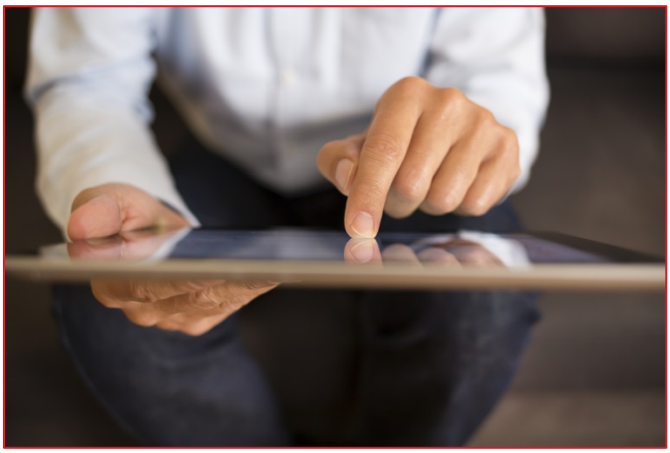
A year and a half later, out of the blue, you receive a cease and desist letter from one of Faultless's most critical vendors, Big Software. The letter alleges that Faultless is using Big Software's application without a license, because Faultless, Inc. didn't obtain Big Software's consent to the assignment to Faultless, LLC of its fully paid perpetual license to Big Software's application. Big Software graciously offers to provide a new paid-up perpetual license to its application in return for Faultless's payment of $650,000. Now what do you do?

Wait a Minute – That Isn't Right, Is It?

You're probably correct. There is no case law directly on point providing that a statutory conversion by a licensee of intellectual property constitutes an assignment for which the consent of the licensor is required, **but some particularly aggressive software vendors have started taking the position of Big Software.**

The software vendors' argument goes something like this: licensee's rights under an intellectual property license are personal in nature, and therefore may not be assigned to a third party without the licensor's consent.

This is, of course, an exception to the general rule that a party to a contract can assign its rights to a third party without the counterparty's consent absent a provision requiring that consent. Some federal courts have extended this exception to mergers, finding that a licensee's rights that are assigned by operation of law in connection with a merger involving the licensee also require the licensor's consent absent a provision in the license specifically allowing assignment by operation of law without the licensor's



consent.[1] Some aggressive software vendors contend that a legal entity that undergoes a statutory conversion assigns its contracts by operation of law to the converted entity.

The aggressive software vendors' position does not have any direct support and is directly contrary to most state statutes governing conversions.[2] Receipt of a cease and desist letter can certainly be a nuisance, however, and their issuance an effective strategy to maximize software license and maintenance revenue.

So What Can We Do?

The most significant action a licensee can take to avoid a difficult negotiation with an aggressive software vendor is to **review closely and negotiate assignment and change in control provisions** in its software licenses. In the course of doing so, a licensee can protect itself from not only the scenario described above, but also from being stuck in a weak negotiating position with a vendor before or after an

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[1] *See,* e.g.*, Cincom Systems, Inc. v. Novelis Corp.*, 581 F.3d 431 (6th Cir. 2009); *SQL Solutions, Inc. v. Oracle Corp.*, 1991 WL 626458 (N.D. Cal. Dec. 18, 1991).

[2] *See*, e.g., Del. General Corporation Law § 266(h) ("When a corporation has been converted to [an LLC], the [LLC] shall, for all purposes of the laws of the State of Delaware, be deemed to be the same entity as the corporation[,]" and "The rights, privileges, powers and interest in property of the corporation that has converted, as well as the debts, liabilities and duties of such corporation, shall not be deemed, as a consequence of the conversion, to have been transferred to the [LLC] to which such corporation has converted for any purpose of the laws of the State of Delaware.").

M&A transaction, or in connection with internal reorganizations involving mergers, dissolutions, assignments, assumptions, stock transfers or conversions.

Software vendors have legitimate reasons for requiring their consent in connection with an M&A transaction between one of their licensees and an unaffiliated third party, such as avoiding licensing the licensor's software to one of its competitors. With a few exceptions, however, those arguments shouldn't apply in connection with an internal reorganization – at least if the license contains usage limitations. A licensor's few legitimate concerns in connection with the transfer of the licensee's license rights in an internal reorganization can be addressed up front in the negotiation of the assignment and change in control provisions.

In the end, the best protection from aggressive software vendors is an ounce of prevention up front.

For more information regarding the effect on license rights of statutory conversions and other corporate transactions, contact John D. Cottingham or Justin D. Tillson.

OCIE Unveils Plan to Examine Never-Before-Examined Advisers

Are You Ready for Your SEC Audit?

The SEC announced on February 20, 2014 that its Office of Compliance Inspections and Examinations (OCIE) is launching an initiative to conduct examinations of a significant percentage of investment advisers who have never been examined, focusing on those who have been registered with the SEC for three or more years. OCIE has indicated that examining these advisers is a priority in 2014. Access our update.

Intellectual Property

Patent Decision Analysis Part 2: Evaluating Market Risks and Benefits

By Beverly Lyman, Ph.D.

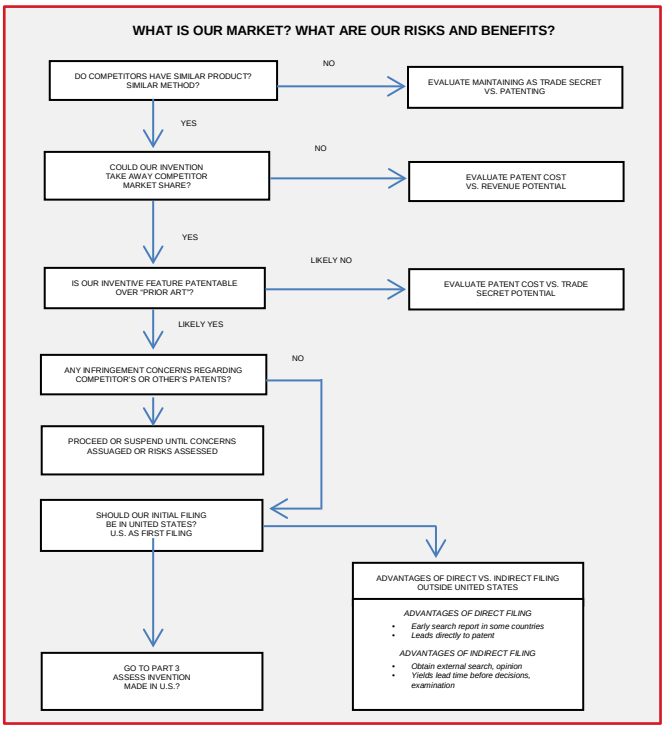
In Part 1, we addressed the question: "Should We Patent?" Part 2 presents a flowchart for analyzing the market for the invention to be patented and raises threshold issues a business should address when contemplating patenting.

For example, safeguarding your invention as a trade secret is an alternative to patenting and still provides valuable intellectual property protection. The legal standards for trade secret protection are a documented business value and bona fide secrecy. The risk, however, is that a competitor may produce the same invention and obtain a patent, preventing you from using your own trade secret. Whether or not trade secret protection is a viable option is circumstance-specific, but it is something to consider.

If the decision is made to patent, an early task is to assess the invention against competitors' products. How is it at least arguably different from current commercial products or methods? What "unmet need" does it fulfill? Is there at least potential to carve out a market niche and erode competitor share?

Next, focus on the inventive part of the product or method and assess whether that part is patentable (either as a stand-alone or combined with a larger unit). Such an analysis casts a wide net; it evaluates everything already known (e.g., products made by competitors and others, publications of all kinds (trade, technical, patents, websites, etc.), public uses even by only one person, etc.). The results of this assessment will likely not be a clear thumbs up or down, but they will indicate the identity and scope of the closest "prior art." At a minimum, you should contemplate this knowledge within your organization, and certainly you must address it externally if you decide to pursue a patent application.

Apart from patenting your invention, it is always prudent to at least consider what, if any, infringement concerns lurk if you commercialize it (the legal infringement standards are: make, use, sell or offer to sell it). This legal evaluation assesses the risk that practicing your invention (product or method) would infringe a third-party-issued valid patent. Because this assessment parses patent claims and determines the patent's validity in a particular country, it is not undertaken lightly. However, it need not be onerous and the outcome either way will be a useful business tool. We will address this further in a later part of this series.



Patents can be filed anywhere in the world. Once issued, their exclusionary effect is geographically limited. There are also geographical nuances, e.g., a patent application filed in the United States requires an export license if it is to be filed outside the United States, even if the invention was created outside the United States. Such details can trip up even the most seasoned business, making the question of where to file a patent application a strategic one. There may be sound business reasons to file the first application in a particular country or region; the flowchart lists a few. Also keep in mind the costs to file, prosecute and maintain a patent over its life, multiplied by the number of countries in which you have filed. These costs add up quickly and the patent's value may or may not justify them.

In conclusion, appreciating the markets your invention will enter and the key players in those markets, pragmatically assessing what a patent will or will not provide to your business, and evaluating your invention against market strengths, weaknesses, opportunities and threats will help provide return on your intellectual property investment.

For more information about patents and associated benefits and risks, contact Beverly Lyman, Ph.D.

Cybercurrency

Accepting Bitcoin: What You Need to Know

By James P. Jalil, Catherine R. Hartman and Emily M. Little

As the Bitcoin market expands its reach to mainstream businesses, more companies are wondering if they could benefit from accepting Bitcoins as payment for goods and services. Before taking the leap, companies should understand the unique issues associated with accepting Bitcoins. Legal and technology questions loom as companies begin to consider the possibility of adding Bitcoin to their business models. To reap the benefits of accepting Bitcoins, however, companies will need to implement certain compliance protocols and procedures, as well as new technology to support the transactions.

Bitcoin, a nascent, math-based virtual currency, has been touted as a reliable currency free from arbitrary intervention by a central authority. Bitcoin differs from conventional government-backed currencies in that it is not issued by a central bank or treasury, has no intrinsic value other than an expectation of future acceptance as payment for goods and services, and is not represented in physical form, i.e., a coin or bill. Bitcoins are created in a process called "mining" that involves solving a complex mathematical problem using sophisticated computer servers. Bitcoins can be traded or exchanged in connection with private sales, or traded on online currency exchanges for traditional paper currency.

Bitcoin's value relative to traditional currencies fluctuates wildly, making trading speculative. Nonetheless, an active Bitcoin exchange market exists, making its acceptance by traditional brick-and-mortar businesses not only possible but, in many ways, as efficient and seamless as accepting traditional currencies. With the right training and implementation of clearly defined procedures, corporate treasury personnel can effectively manage the valuation, hedging and trading of Bitcoins.

In summary, companies may legally accept Bitcoins as payment for goods and services, and indeed such transactions may be executed with the same relative ease as those of traditional currency. Additionally, Bitcoin's ability to remain seemingly free from manipulation and fraud offers enhanced protection from data security breaches, which are harmful to customers and businesses alike, and which have continuously been associated with the use of credit and debit cards.

Regulatory Developments

Virtual currencies have attracted the attention of courts and financial regulators alike, which has helped those currencies, including Bitcoin, gain an additional measure of legitimacy in the market. According to a recent federal court decision, Bitcoin "can be used as money" because it has characteristics of a "currency or form of money."[1] Despite the currency's legitimacy and ease of use, companies contemplating accepting Bitcoins should establish special protocols and procedures to satisfy anti-money-laundering obligations under the Bank Secrecy Act.

Companies wishing to take advantage of the rapidly growing virtual currency market should first learn how to ensure their conduct complies with relevant laws and regulations. A company must first address the question of whether or not it qualifies as a "money transmitter"– a type of "money services business" under the Bank Secrecy Act. Answering this preliminary question will allow the company to quickly identify its potential regulatory and reporting obligations. If a business qualifies as a money transmitter, it will be regulated as such by federal, state and, in some cases, even local agencies, including the obligation to register and become licensed.

In March 2013, U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) issued federal regulatory guidance suggesting that individuals or companies who exchange or administer the transmission, purchase or sale of virtual currency, including Bitcoin, are considered "money transmitters" and are likely obligated to comply with the Bank Secrecy Act requirements.

[1] *SEC v. Shavers*, No. 4:13-CV-00416, 2013 U.S. Dist. LEXIS 110018 (E.D. Tex. Aug. 6, 2013).

According to the FinCEN guidance, "A person that creates units of convertible virtual currency and sells those units to another person for real currency or its equivalent is engaged in transmission to another location and is a money transmitter." On the other hand, the guidance indicates that individuals and companies using Bitcoins solely for their own purposes and not for the benefit of another are *not* money transmitters. The same goes for companies investing in Bitcoin for the company's own benefit. So, a company that accepts payment in Bitcoins and then exchanges them for a traditional currency is not a money transmitter under the regulator's guidelines. This results in a real benefit to companies because they can enter a new segment of the electronic market while at the same time avoiding exposing the company's balance sheet to the inherently volatile valuation of electronic currency.

For further information about preparing your company for Bitcoin acceptance, please contact James P. Jalil or Catherine R. Hartman, or any member of the firm's Cybercurrency practice group.

Thompson Hine LLP Advises OASE Group in GeoGlobal Acquisition

NEW YORK – March 7, 2014 – A team from Thompson Hine LLP represented OASE Group, headquartered in Hörstel, Germany, in its acquisition of GeoGlobal Partners, the leading North American provider of innovative water gardening products, headquartered in West Palm Beach, Florida. The Equistone Partners Europe Funds are the majority shareholders of OASE Group. Thompson Hine worked closely with Pöllath + Partners of Munich, Germany on the transaction.

The transaction aims to strengthen OASE Group's leading market position in the United States, as well as to outline the joint position as global market leader of water gardens.

Thompson Hine partners **Garrett Evers**, **Frank Chaiken** and **Laura Ryan**, along with associates **Bradford Meacham** and **Matthew Vaughan**, advised on M&A issues. Financing counsel was provided by partner **David Naftzinger** and associates **Tiffany Williams** and **Nelson Crichton.**

Energy Markets

Policing Price Manipulation in Energy Markets: Finding the Jurisdictional Boundaries

By Peter C. Lesch

Both the Commodity Futures Trading Commission (CFTC) and the Federal Energy Regulatory Commission (FERC) are authorized to police and sanction price manipulation in the markets subject to their respective jurisdictions. As it is commonplace for transactions in financial markets to affect pricing in physical commodities markets, and vice versa, questions have arisen over the extent to which the FERC, in particular, may exercise jurisdiction to investigate and sanction cross-market manipulation in energy markets. While these questions are still being worked out, traders of financial instruments and physical commodities in energy markets should be aware of both regulatory regimes.

Pertinent Statutory Mandates

The Energy Policy Act of 2005 (EPAct 2005) included amendments to the Natural Gas Act and the Federal Power Act that vest the FERC with authority to issue and enforce rules prohibiting manipulation in energy markets. More specifically, the amendments make it unlawful for any entity to use "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of natural gas or electric energy, or transportation/transmission services for the commodities, subject to the FERC's jurisdiction.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), enacted in 2010, included amendments to the Commodity Exchange Act (CEA) that broadened the CFTC's preexisting anti-manipulation authority with respect to derivatives and commodities. The amendments make it unlawful for any person to use "any manipulative or deceptive device or contrivance" in connection with "any swap or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity." The CFTC interprets this prohibition to encompass any effort to improperly influence the price of a swap, commodity or commodity futures contract.

…the outcome of the Barclays proceeding could determine whether current statutes give the FERC any jurisdiction over cross-market manipulation involving both exchange-based energy derivatives markets and physical commodities markets.

The FERC and CFTC mandates are both modeled closely on the anti-manipulation provisions of the Securities and Exchange Act of 1934. Accordingly, both agencies have fashioned their implementing regulations (codified at 18 CFR Part 1c and 17 CFR Part 180, respectively) after the Securities and Exchange Commission's Rule 10b-5, and look for guidance in the body of judicial precedent interpreting that rule.

FERC Enforcement Directed at Cross-Market Manipulation

Fortified by a greatly increased enforcement staff and stiffer civil and criminal penalties authorized under EPAct 2005, the FERC has pursued its mandate aggressively. One of the early cases in which the FERC applied its anti-manipulation authority involved Brian Hunter, an employee of the hedge fund Amaranth Advisors. Hunter had made sales of natural gas futures contracts on the NYMEX, the volume and timing of which led to a reduction in the price for physical natural gas. Hunter also held a related portfolio of swap-based derivatives purchased on the Intercontinental Exchange (ICE) that had been positioned to capitalize on the decline in the price for natural gas, and from which he profited.

The FERC brought an enforcement action, claiming that Hunter's manipulation of the settlement price of futures contracts affected the price of natural gas in FERC-regulated markets. The FERC proceeding culminated in a finding against Hunter and imposition of a $30 million fine.

Hunter petitioned for review of the FERC's order, arguing, among other things, that the FERC was without authority to bring the action because the CFTC has exclusive jurisdiction

over manipulation of futures contract prices. The CFTC intervened in the appellate proceeding in support of Hunter's jurisdictional challenge. In *Hunter v. FERC,* 711 F.3d 155 (D.C. Cir. 2013), the court granted Hunter's petition, finding that the CEA gives the CFTC exclusive jurisdiction over transactions conducted on futures markets like the NYMEX, and that the FERC therefore lacked authority to charge Hunter with manipulation of natural gas futures contracts.

The alleged manipulative activity in the *Hunter* case involved the purchase and sale of financial instruments only; Hunter did not purchase or sell any physical commodities in transactions subject to the FERC's direct jurisdiction. In other cases, the FERC has pursued instances of alleged cross-market manipulation that involved purchases and sales of physical commodities as well as trading in financial instruments. For example, the FERC brought an enforcement action against Barclays Bank, PLC and several individual traders (collectively, Barclays), charging that they had engaged in loss-generating trading of physical electricity on the ICE with the intent to benefit financial swap positions at certain electricity trading points. The FERC ultimately found against Barclays, assessing civil penalties totaling $453 million and ordering disgorgement of $34.9 million in unjust profits.

Barclays elected to force de novo review of the FERC's action in federal court by declining to pay the penalties. The FERC filed an action to affirm the penalties in the U.S. District Court for the Eastern District of California (*FERC v. Barclays Bank PLC,* No. 2:13-cv-02093). Barclays filed a motion to dismiss the FERC's complaint, arguing, among other things, that the CEA grants the CFTC exclusive jurisdiction over transactions involving commodity futures contracts such as the swap contracts that Barclays traded on the ICE. With reference to physical commodities, Barclays also argued that the FERC's jurisdiction is limited to the transmission and sale of electric energy that is physically transmitted in interstate commerce, and that Barclays simply purchased and sold equal and offsetting amounts of electricity without actually engaging in the physical receipt or delivery of the commodity.

In January 2014 the district court issued an order putting the penalties on hold while the court considers whether or not to dismiss the case or transfer it to another district court venue. Depending on what issues are deemed controlling and how they are decided, the outcome of the *Barclays* proceeding could determine whether current statutes give the FERC any jurisdiction over cross-market manipulation involving both exchange-based energy derivatives markets and physical commodities markets.

MOUs

Dodd-Frank required the CFTC and the FERC to negotiate two memoranda of understanding concerning regulatory coordination and information sharing, respectively. Those MOUs were signed on January 2, 2014, nearly three years after the statutory deadline. While the MOU on regulatory coordination contains procedures for the agencies to resolve jurisdictional disputes, it appears that a clearer delineation of the boundaries of such jurisdiction may ultimately have to be determined by the courts or prescribed by Congress.

To learn more about price manipulation in energy markets, contact Peter C. Lesch.