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The Xerox Takeover Saga

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Editor's note: Steve Wolosky, Andrew Freedman, and Ron Berenblat are partners at Olshan Frome Wolosky LLP. This post is based on an Olshan publication by Mr. Wolosky, Mr. Freedman, and Mr. Berenblat.

Related research from the Program on Corporate Governance includes Dancing with Activists by Lucian Bebchuk, Alon Brav, Wei Jiang, and Thomas Keusch (discussed on the Forum here).

On April 27, 2018, the New York State Supreme Court issued an important decision temporarily blocking a proposed business combination between Xerox Corporation ("Xerox") and Fuji Xerox Co., Ltd. ("Fuji Xerox"), the longstanding joint venture between Xerox and Fujifilm Holdings Corporation ("Fuji"). The "lynchpin" of the Court's decision to block the transaction turned on the conduct of Xerox's "massively conflicted" CEO Jeff Jacobson in negotiating the transaction, and the Board's "acquiescence" to such conduct. The Court was convinced that once Jacobson learned that Carl Icahn, the largest shareholder, and the board of directors of Xerox (the "Board") were seeking to replace him as CEO, he "abandoned the Board's request to obtain a value-maximizing all-cash transaction and engineered the framework for a one-sided deal" with Fuji that would result in him retaining the CEO position with the combined company.

In addition to blocking the transaction, the Court enjoined Xerox from enforcing its nomination deadline for its 2018 annual meeting of shareholders (the "2018 Annual Meeting"), representing a monumental victory for shareholder activists. This post focuses on the Court's decision to enjoin enforcement of the nomination deadline given the major impact we believe it will have on strategies that could be deployed by shareholder activists after a nomination deadline has passed.

Background of the Consolidated Case and Settlement

On January 31, 2018, Xerox and Fuji publicly announced a transaction to combine Xerox with Fuji Xerox where Fuji would own 50.1% of the combined company and Xerox shareholders would own 49.9% of the combined company and receive a special cash dividend of approximately $9.80 per share. On February 13, 2018, Darwin Deason, the third largest shareholder of Xerox, filed suit and sought a preliminary injunction to stop the transaction. Deason also sued Fuji under an aiding and abetting theory related to the alleged fiduciary duty breaches in connection with the Board approving the transaction. Class action plaintiffs also filed suit on behalf of all Xerox shareholders and also sought a preliminary injunction to stop the transaction.

On February 26, 2018, Deason requested that Xerox waive its advance notice bylaw provision so that he could nominate a slate of directors for election at the 2018 Annual Meeting; the Board refused to grant a waiver. Deason filed a second suit on March 2, 2018 seeking a preliminary injunction to prevent Xerox from enforcing its advance notice bylaw and ordering Xerox to allow him to nominate a slate of directors.

The cases were assigned to Justice Ostrager of the New York Supreme Court's Commercial Division, who consolidated all of the actions for purposes of discovery and trial.

Shortly after the Court rendered its decision, Xerox, Deason and Icahn entered into a settlement agreement resolving Deason's and Icahn's proxy contest against Xerox and Deason's litigation against the company and its directors. Under the settlement agreement, Jacobson will resign as CEO and a director. In addition, a total of seven of the ten current directors will be replaced with a mix of six individuals handpicked by Deason and Icahn. The reconstituted Board plans to evaluate all strategic alternatives, including "terminating or restructuring" the proposed transaction as well as Xerox's partnership with Fuji. The settlement has no effect on Deason's pending aiding and abetting claims against Fuji. The settlement is subject to execution by the Court of stipulations discontinuing Deason's suits as to the Xerox defendants. Fuji has indicated that it will file with the Court objections to the settlement.

Decision to Waive Nomination Deadline

In addition to seeking to enjoin the transaction, Deason sought to prevent Xerox from enforcing its December 11, 2017 nomination deadline in connection with the 2018 Annual Meeting and to allow him and other shareholders to nominate directors at the meeting. Deason alleged that several weeks after the nomination deadline, Xerox made a "series of very significant decisions and disclosures" that were extremely material to Deason's decision as to whether he should nominate directors, including:

- The announcement by Xerox and Fuji of the proposed business combination;
- Xerox's disclosure of the terms of the business combination, which Deason believes would dramatically favor Fuji, provide an inadequate control premium to Xerox shareholders and would leave Xerox shareholders "hostage and subject to abuse by Fuji;" and
- Xerox's disclosure, for the first time, of certain material agreements relating to Fuji Xerox, including a so-called "crown jewel" lock up right in favor of Fuji under the joint venture, which Deason alleged effectively gave Fuji a "blocking position on Xerox's ability to sell itself to anyone other than Fuji".

After these disclosures were made, Deason sent a letter to Xerox expressing his desire to nominate a full slate of directors at the 2018 Annual Meeting. Deason stated that while the December 11 nomination deadline had passed, he had the right to nominate directors at the annual meeting as Xerox's post-nomination deadline revelations constituted a "material" change in Xerox's circumstances. Deason requested a waiver of enforcement of the nomination deadline. Deason filed suit after Xerox rejected his waiver request.

In the lawsuit, Deason acknowledged the absence of controlling New York case law and asked the Court to look to *Hubbard v. Hollywood Park Realty Enters., Inc.*, the leading Delaware

Chancery Court case on this issue. In *Hubbard*, the Delaware court granted a shareholder group's motion for preliminary injunction seeking to enjoin the operation of an advance notice nomination bylaw after it found that "an unanticipated change of allegiance of a majority of [the board]" occurred after the nomination deadline had passed.

In making its determination, the court in *Hubbard* focused on the following three questions: (1) Did a change in circumstances occur after the nomination deadline? (2) Was the change "unanticipated" and "material"? and (3) Was the change caused by the board? In the case at hand, Deason argued that the three-pronged *Hubbard* test had been satisfied.

Xerox countered by portraying Deason's actions as a "belated" attempt to expand the minority slate timely nominated by Carl Icahn, with whom Deason formed a Section 13(d) group prior to requesting the waiver, into a full slate for the purpose of taking complete control of the Board "as punishment for its unanimous decision to approve the Transaction."

Xerox noted that no New York court had ever enjoined a public company from enforcing a nomination deadline and that, even if *Hubbard* applied, Deason failed to demonstrate that there was a "drastic and wholly unanticipated change in circumstances, where shareholders will otherwise be deprived of the ability to be heard on the direction of the company." To the contrary, Xerox argued that shareholders will have the ability to weigh in on the future direction of the company, not once but twice—to elect directors (including the Icahn slate) at the 2018 Annual Meeting and again to vote on the business combination at a special meeting.

Xerox also argued that these disclosures were neither drastic nor unanticipated given Deason's extensive communications with the company regarding Fuji Xerox during the months prior to the nomination deadline. Beginning in May 2017, Deason expressed concerns that Fuji Xerox could jeopardize the value of Xerox in the event of a change of control and his suspicion that the joint venture appeared to be benefiting Fuji more than Xerox. He also urged Xerox to explore strategic alternatives with respect to the joint venture. Accordingly, Xerox claimed that it was foreseeable to Deason that a transaction with Fuji Xerox could have been announced after the nomination deadline and that the joint venture agreements could contain "deal-prohibitive" restrictions.

Finally, Xerox attacked Deason's assertion that he would have nominated an opposition slate had the business combination been announced and the material agreements relating to Fuji Xerox been disclosed prior to the nomination deadline. Deason, according to Xerox, was free to nominate prior to the nomination deadline, and chose not to despite having already been "focused intensely" for several months on the Fuji Xerox relationship and in a position to anticipate the post-deadline developments.

In granting Deason's motion for an injunction to compel Xerox to waive the advance notice bylaw, the Court adopted the *Hubbard* standard, finding that its reasoning was directly applicable to the case at hand. Quoting directly from *Hubbard*, Justice Ostrager stated:

It is well-settled law that a shareholder is entitled to a waiver of a corporation's advance notice deadline for nominating directors when there is a material change in circumstances of the corporation after the nomination deadline. Certain material, post-deadline changes in business policy and direction may "foreseeably generate controversy and shareholder opposition. Under those circumstances, considerations of fairness and the fundamental importance of the

shareholder franchise dictate[] that the shareholders be afforded a fair opportunity to nominate an opposing slate, thus imposing upon the board the duty to waive the advance notice requirement of the by-law."

In this case, the Court agreed with Deason that the significant decisions regarding the proposed business combination and the material disclosures regarding the joint venture agreements, including the "crown jewel" lock up right, that were made several weeks after the nomination deadline were material with respect to Deason's decision to nominate a competing slate of directors. In addition, while shareholders who opposed the transaction would have an opportunity to vote against it, the Court stated that allowing Deason to nominate a competing slate is a "fair and logical" means of providing shareholders with options relating to the deal. The Court stated:

The balance of equities clearly tips in favor of waiving the advance notice bylaw deadline for director nominations. An injunction will enable Deason and any other shareholder to nominate a competing slate of directors who can represent their legitimate interests in determining the future direction of Xerox following a series of decisions and disclosures regarding a potential change of control transaction with Fuji. Defendants, by contrast, will suffer no cognizable harm if the Court allows for a brief period in which shareholders may nominate competing director candidates for the upcoming 2018 annual meeting.

The Court concluded that Xerox's refusal to waive the nomination deadline was "without justification" and the defendants "likely breached their fiduciary duty of loyalty by refusing to waive the advance notice bylaw deadline to allow a competing slate of candidates so as to protect and secure their existing Board positions."

Key Takeaways for Activists

The New York State Supreme Court's adoption of the *Hubbard* standard represents a great victory for shareholder activists. New York is now the first state outside Delaware to adopt the *Hubbard* standard, and we would not be surprised if other states follow suit in response to a multitude of future lawsuits seeking to reopen nomination windows that we expect to see now that *Hubbard* has been resurrected. Shareholder activists should become familiar with *Hubbard* as it is not uncommon for companies to make highly significant decisions and disclosures right after a nomination deadline has passed. A more detailed factual and legal analysis of *Hubbard* and its three-pronged standard can be found in our previous Client Alert on this topic.