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## INSIGHT: First Department Reverses Injunctions Against Fuji-Xerox Merger



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On October 16, 2018, the Appellate Division, First Department lifted several injunctions granted by the Commercial Division that had restrained a proposed merger deal between Xerox and Fujifilm (“Fuji”), and dismissed the Xerox shareholders’ actions against Fuji. *Deason v. Fujifilm Holdings Corp.*, No. 650675/18, 2018 BL 380437 (App. Div. 1st Dep’t Oct. 16, 2018). This appeal overturned decisions by Justice Barry Ostrager of the New York Commercial Division that led to a change in Xerox’s Board of Directors, and resulted in six Board seats being selected by two minority shareholders, Carl Icahn and Darwin Deason. Although the First Department lifted the injunctions (allowing the proposed deal to go forward if it remains viable), the changes to Xerox’s Board of Directors likely cannot be undone. As discussed in more detail below, the parties’ settlement agreements contemplate the new Xerox Board pursuing another future Xerox acquisition with Fuji or other third parties.

**Xerox and Fuji’s Relationship** Xerox and Fuji have operated under a joint venture agreement for years. See *In re Xerox Corp. Consol. S’holder Litig.*, No. 650766/18, 2018 BL 153808, at \*1 (Sup. Ct. Apr. 27, 2018); see also *In re Xerox Corp. Consol. S’holder Litig.*, No. 650766/2018, NYSCEF Doc. No. 2 (Fuji Xerox Joint Enterprise Contract). As part of this joint venture (“Fuji Xerox”) the parties entered into a technology agreement, under which Xerox granted to Fuji Xerox a royalty-free, exclusive license to certain intellectual property to make, use, lease, sell or distribute such property throughout Asia, Australia, and New Zealand. Currently, Fuji owns a 75 percent interest in Fuji Xerox, and Xerox’s rela-

tionship to Fuji Xerox accounts for approximately 25 percent of Xerox’s total revenues. *In re Xerox Corp. Consol. S’holder Litig.*, No. 650766/18, 2018 BL 153808, at \*1. The joint venture agreement between Fuji and Xerox, however, contains a number of provisions that make it difficult for Xerox to engage in transactions with parties other than Fuji in these regions. See *id.* For example, Xerox is prohibited from selling more than 30 percent of its outstanding shares to a competitor of Fuji without cancelling the joint venture, and losing the rights to the technology that Xerox contributed to the joint venture. *Id.* at \*2.

In early 2017, Fuji’s CEO, Shigetaka Komori, inquired whether Xerox would be interested in being acquired by Fuji. *Id.* at \*3. Xerox’s then-CEO, Jeff Jacobson, responded that Xerox would only consider a deal if Fuji’s offer reflected an “appropriate premium to our current trading price,” and, importantly, provided “our shareholders 100% cash consideration.” *Id.* at \*3–4. Fuji eventually informed Xerox that a cash purchase of all of Xerox’s shares would be too expensive for Fuji. *Id.* at \*4.

Following these initial negotiations, Jacobson met with Carl Icahn, a Xerox investor. *Id.* Icahn informed Jacobson that he did not believe that Jacobson was the right person to serve as CEO of Xerox. *Id.* Jacobson communicated this to the Xerox Board. *Id.* Thereafter, Jacobson and Xerox’s investment banking advisor, Centerview Partners, developed a transaction structure that would allow Fuji to pursue a cash-less acquisition of Xerox. *Id.* Although Icahn pressured Jacobson and the Xerox Board to consider a deal, he opposed this cash-less transaction, and requested that a search committee be formed to identify a replacement CEO. *Id.* at

\*4-5. The Xerox Board agreed, and began actively identifying potential candidates to replace Jacobson. *Id.* at \*5.

In November 2017, the Xerox Board informed Jacobson that he might be replaced as CEO, and told him to stop any discussions regarding a combination with Fuji. *Id.* Jacobson communicated this instruction to his Fuji counterparts. *Id.* at \*5-6. Nonetheless, with the authorization of Robert Keegan, the Chairman of Xerox's Board, Jacobson, along with certain members of the Xerox Board, continued negotiations for Fuji's cash-less acquisition of Xerox. *Id.* at \*6. The Xerox Board appointed a four-person committee to monitor the negotiations. *Id.* Despite having pursued a replacement CEO, the Xerox Board eventually insisted that Jacobson remain the company's CEO following any Fuji transaction, and Fuji readily conceded this point. *Id.* at \*8-9.

As the negotiations continued, Jacobson communicated with individuals at Fuji about attempts by Icahn and the Xerox Board to fire him as CEO. The Fuji representatives responded with statements of their support for and loyalty to Jacobson. *Id.* at 8-9. Ultimately, once the cash-less transaction (the "Xerox-Fuji Transaction") was scheduled for a shareholder vote, Deason and the class plaintiffs sought a preliminary injunction from the Commercial Division, which would prevent any further action on the Xerox-Fuji Transaction.

**The Commercial Division Enjoins the Xerox-Fuji Transaction** The litigation reached the Commercial Division on separate motions for preliminary injunctions brought by Deason and the class plaintiffs (certain pension funds that hold shares in Xerox). The consolidated Xerox litigation covers a series of separate actions filed by several groups of Xerox investors: (1) Asbestos Workers Philadelphia Pension Fund, Iron Workers District Council of Philadelphia & Vicinity Benefit and Pension Plan, Carpenters Pension Plan of Illinois, and Robert Lowinger (collectively "Class Plaintiffs"), in an action against Xerox titled *In re Xerox Corp. Consol. S'holder Litig.*, No. 650766/2018; (2) minority shareholders Deason and Icahn in an action against Fuji, captioned *Deason v. Fujifilm Holdings Corp., et al.*, No. 650675/2018 ("Deason I"); and (3) minority shareholders Deason and Icahn in an action against Xerox, titled *Deason v. Xerox Corp., et al.*, No. 650998/2018 ("Deason II"). See *In re Xerox Corp. Consol. S'holder Litig.*, No. 650766/2018, NYSCEF Doc. No. 65 (Mar. 23, 2018).

On April 27, 2018, Justice Barry Ostrager of the New York Commercial Division enjoined the proposed Xerox-Fuji Transaction in a ruling affecting all three cases. Xerox and its Board of Directors (the "Xerox Defendants") argued that their decision to approve the Xerox-Fuji Transaction was entitled to deference under "the business judgment rule." Under New York law, however, when corporate officers and directors have an interest in a decision, such that they are conflicted, the business judgment rule does not apply. The Court found that Deason and the Class Plaintiffs had demonstrated a likelihood of success on the merits on their claim that Xerox's then-CEO Jeff Jacobson was conflicted, because of his interest in remaining CEO after the proposed merger. See *In re Xerox Corp. Consol. S'holder Litig.*, No. 650766/18, 2018 BL 153808, at \*11. Justice Ostrager's holding that the Xerox Board likely breached its fiduciary duty to Xerox's shareholders was also based in part on a clause in the parties' agreement

that secured board positions for five of the Xerox Board members in the merged entity. *Id.* at \*9. Because the Court concluded that Jacobson and five of the Xerox Board members were conflicted, it ruled that the business judgment rule did not apply to the Xerox Board's decision to enter into the Xerox-Fuji Transaction. *Id.* at \*10-11.

The proposed transaction was instead reviewed under a less-exacting "entire fairness" standard, which reviews whether a transaction was the result of "fair dealing" and is at a "fair price." *Id.* at \*11. Justice Ostrager found that, under the entire fairness standard, "Plaintiffs have demonstrated a probability of success in establishing that the director defendants, a majority of whom would have future directorship positions on the board of the combined entity, acted in bad faith in structuring and negotiating the proposed transaction." *Id.* at \*12.

Justice Ostrager also held that plaintiffs were likely to succeed on their claims against Fuji, that it had aided and abetted the Xerox Defendants' fiduciary duty breaches. *Id.* Under New York law, "[a] claim for aiding and abetting fiduciary duty requires (1) a breach by a fiduciary of obligations to another; (2) that the defendant knowingly induced or participated in the breach; and (3) that plaintiff suffered damage as a result of the breach." *Id.* (citation omitted). Importantly, an individual may be held liable for aiding and abetting a breach of fiduciary duty even when they have no independent fiduciary obligation to the injured party. *Id.* The Commercial Division determined that Fuji's representatives were aware of Jacobson's conflict and used this knowledge to further the proposed Xerox-Fuji Transaction. *Id.* at \*12-13.

Just days after the Court's decision, an agreement was reached through which the CEO of Xerox, Jeff Jacobson, and six other current Xerox Board members would step down from their positions, thereby ceding control of the company to representatives of minority investors Icahn and Deason. Shortly thereafter, Xerox reversed course, indicating publicly that Jacobson would stay on as CEO.

**The Parties' Settlements Result in a New Xerox Board** On May 13, 2018, Xerox entered into a settlement with shareholder Deason, and a memorandum of understanding with the remaining shareholder Class Plaintiffs, agreeing to end the dispute between Xerox investors and the Board. See *In re Xerox Corp. Consol. S'holder Litig.*, No. 650766/2018, NYSCEF Doc. No. 640, at 12-13. Deason entered into a settlement with the Xerox Defendants, disposing of *Deason II*. Under the terms of that agreement, certain Xerox Directors resigned from the Board, and provided that the new Board be composed of continuing Xerox Directors, and six incoming directors to be selected by Deason and Icahn. *In re Xerox Corp. Consol. S'holder Litig.*, No. 650766/2018, NYSCEF Doc. No. 564. Deason further agreed to withdraw his request for injunctive relief against the Xerox Defendants, but not against Fuji. *Id.* at 1.

Under the terms of the Class Plaintiffs' settlement agreement, which was amended in July 2018, the Class Plaintiffs agreed to end their lawsuit against the Xerox Defendants. The settlement contained similar terms: Resigning Directors and Jacobson would step down from the Board, and the new Board agreed "that they

intend to pursue reasonable efforts to identify and evaluate whether to consummate a value maximizing transaction, whether with Fuji or any other third party, or combination of third parties.” *In re Xerox Corp. Consol. S’holder Litig.*, No. 650766/2018, NYSCEF Doc. No. 750, at 13–14. The Class Plaintiffs further agreed to withdraw their request for injunctive relief only with respect to the Xerox Defendants. *Id.* at 14–15. As a result, the Class Plaintiffs’ settlement with Xerox, like the Deason memorandum of understanding, did not resolve their claims against Fuji. *Id.* Notably, the amended proposed settlement was put in place to “clarify” that the class plaintiffs did not settle “any claims or causes of action of any kind whatsoever that Xerox has or may assert in its own right against Fuji, or against any agents, representatives, advisors, consultants or attorneys of either (i) the Director Defendants; or (ii) Xerox.” *In re Xerox Corp. Consol. S’holder Litig.*, No. 650766/2018, NYSCEF Doc. No. 677, at 1. These settlements thus left the Deason and Class Plaintiffs’ actions against Fuji in place.

***The Commercial Division Declines to Lift the Preliminary Injunctions Following Settlements*** Thereafter, in accordance with the parties’ settlement terms, Xerox Defendants and the Class Plaintiffs asked Justice Ostrager to stay the litigation and vacate the injunctions only as against the Xerox Defendants. *See In re Xerox Corp. Consol. S’holder Litig.*, No. 650766/2018, Tr., NYSCEF Doc. No. 640, at 7, 8. Fuji moved to dissolve the injunctions against it, arguing that it makes little sense to have an injunction against only Fuji. *Id.* at 8, 11–12. According to Fuji, the aiding and abetting allegations against it, which were the basis for the preliminary injunctions, ought not to stand where the primary defendants who allegedly breached their fiduciary duties would no longer be subject to the injunctions. *Id.* at 10. The Court denied all parties’ requests to lift the preliminary injunctions, on the grounds that the injunctions only enjoined the specific transaction at issue:

The preliminary injunction against Fuji . . . related exclusively to a specific transaction, and that . . . injunction in no way, shape or form precluded other and different transactions that Xerox and Fuji might or might not seek to enter into. . . . I don’t see any reason why I should dissolve the preliminary injunction that was issued . . . .

*Id.* at 8–9. Fuji appealed to the Appellate Division.

***The First Department’s Decision Lifting the Injunction*** On appeal, Fuji argued that the Commercial Division erred in granting the preliminary injunctions and improperly declined to apply New York’s business judgment rule on Fuji’s motion to dismiss. Appellant’s Br., *Deason v. Fujifilm*, Nos. 2018-1283, 2018-1928 (1st Dep’t July 16, 2018). According to Fuji, Justice Ostrager inappropriately substituted his judgment—instead of applying New York’s “business judgment rule”—to the Xerox Board’s decision to enter into the Xerox-Fuji

Transaction. Fuji argued that Jacobson’s role as CEO in the new Xerox-Fuji Company was not the type of conflict that precluded application of the business judgment rule, and that a majority of the Xerox Board otherwise carefully considered the proposed merger, and decided that it was in the company’s best interests.

The First Department agreed with Fuji and applied the business judgment rule to the Xerox Board’s decision to approve the Xerox-Fuji Transaction. *Deason*, No. 650675/18, 2018 BL 380437. Under this standard, Deason and the Class Plaintiffs were unable to show a likelihood of success on the merits of their fiduciary duty claims. The First Department ruled that an agreement that five members of the current Xerox Board would serve on the board of the new company was not “a material benefit such that it was a disabling interest.” *Id.* at \*1. The Court further concluded that then-CEO Jacobson’s conflict had been acknowledged by the Xerox Board, that he did not mislead or misinform the Xerox Board, and that the Xerox Board took steps to ensure the viability of the Xerox-Fuji Transaction by engaging outside advisors prior to putting the Transaction to a vote of the shareholders. *Id.* For these reasons, the Court determined that the business judgment rule applied, and vacated the preliminary injunctions. *Id.* at \*1–2. The Court also dismissed the plaintiffs’ aiding and abetting a fiduciary duty breach claim against Fuji, holding that plaintiffs had failed to plead the claim with particularity. *Id.* at \*2. Notably, because the First Department concluded that the preliminary injunction was improperly granted, it did not decide whether the IAS court improperly kept the injunction in place after Deason and class plaintiffs entered into settlement agreements.

***Conclusions*** As mentioned, since the time of Justice Ostrager’s injunctions, a minority shareholder faction took control of the Xerox Board, in accordance with the Class Plaintiffs’ and Deason’s settlements with Xerox, and Xerox’s former CEO has left the company. The First Department’s reversal of the injunctions will not upset this major change in the governance of Xerox.

The settlements contemplate that the new Board will pursue a future transaction, whether with Fuji or otherwise. It may turn out that the previously proposed Xerox-Fuji Transaction may be the best that Xerox can do. Given the terms of the Fuji Xerox joint venture, Fuji may have the inside edge in pursuing an acquisition of Xerox, given that it controls the venture’s IP rights in Asia. Regardless of the First Department’s reversal of the injunctions, it remains to be seen whether and if so, how the Fuji-Xerox Transaction will proceed, or if Xerox will be able to pursue alternative deals.

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