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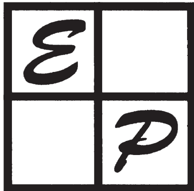

DEAL LAWYERS

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10 Most Influential M&A Developments of this Millennium

By Barbara Borden & Jennifer Fonner DiNucci, Partners, Cooley, LLP

As we turn the page on a new year, many of us reflect upon the noteworthy events of the past as we look forward to the future. Deal lawyers are not exempt from this phenomenon. We present herewith our choices for the 10 Most Influential M&A Developments of this Millennium and a few predictions for the future. Though our observations may not attract the same degree of public attention as *Time's* "Person of the Year," we expect just as much protestation from this audience ("how could you have left off *Dell/Icahn*") as besets *People's* "Sexiest Man Alive" issue—but please make sure you properly address your complaints, as *People* would surely be quite confused....

1. "Selling a Public Company" for Dummies. Early on in the millennium, deal lawyers joyously welcomed *Toys "R" Us* as providing much needed guidance on a myriad of issues involved in both structuring the sales process and negotiating the terms of the agreement itself. The fact that there is little remarkable about it today speaks volumes about the impact it has had on our practice.
2. Deal Litigation du Jour. The advent of virtually automatic deal litigation over public company acquisitions put new emphasis on the duty of candor and changed the face of stockholder disclosure, with more fulsome disclosure of the sale process, financial projections, fees paid to financial advisors and the analyses underlying the banker's fairness opinion. Has all this disclosure been more valuable to investors or to plaintiffs' attorneys seeking fees? Regardless, detailed disclosure is here to stay.

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3. Financial Advisors Are Conflicted? *Del Monte* and the subsequent damages award provided a wake up call on financial advisor conflicts of interest and the risks of sell-side financial advisors providing buyer financing. Seller boards now pose conflict of interest questions to their bankers and are disinclined to allow their advisors to participate in buy side financing. But if your banker has no conflicts, does it have the connections for the job? Conflicts will remain an area of risk and banks will improve in identifying and disclosing potential conflicts earlier in the process.

4. Controlling and Interested Party Transactions, Entire Fairness and the Rise of the "Unified Standard." A host of cases have moved us down a convoluted path of burden-shifting and standard setting in transactions involving controlling or interested parties. The recent *MFW* case may be the Toys "R" Us of the decade if it stands up to scrutiny and brings more cohesion to what is currently the most complex corner of M&A law.

5. Attack of the MAC. *IBP/Tyson* and *Frontier Oil/Holly* were followed by a spate of financed deals involving claims of "material adverse change" in beleaguered 2008, (witness *Genesco/Finish Line* and *Hexion/Huntsman*), and was the subject of the recent *Osram Sylvania /Townsend Ventures case. N*o other defined term has received more attention in the M&A world. Do we know what it means yet? Probably not, but we'll all likely stay the course with deliberately vague language and the courts will have more opportunities to weigh in.

6. Protection from Deal Protections. In a variety of instances, the Delaware Chancery Court has shown a reluctance to enjoin a transaction that has a "standard" mix of deal protections, but if the parties have to amend an agreement's aggressive deal protections to settle litigation, the Court may award substantial fees (see *Compellent Technologies)*. Will this curb strong-arming buyer behavior? Buyers beware.

7. The Golden Age of Tender Offers. The SEC's amendments to the "all-holders, best price" rule gave new life to the two-step tender offer, and the adoption of Section 251(h) of the Delaware General Corporation Law virtually eliminated the need for top-up options and dual track tender offers and should eliminate the need for 14f-1 information statements. There's a cloud hanging over 251(h) and obtaining support (tender) agreements in connection with tender offers, but we predict Delaware will provide statutory clarification.

8. Private Companies, Public Scrutiny. Fiduciary duties and entire fairness review have never been just for public companies, a fact seemingly sometimes lost on private company boards. *In re Trados* is a reminder, particularly to preferred investors and their board representatives, that process matters in private company deals too. We predict private company sell-side deal processes will come more into alignment (though likely still far from aligned) with what we see in public company practice.

9. Omnicare Ails Us. It changed practice, gave us SEC headaches in private company S-4 deals and is broadly viewed as the precedent "Most Likely Not to Succeed." Predict we will see its demise in this decade.

10. Don't Ask, Don't Waive. Did you start the millennium thinking it would be reasonable to ask your sell-side client's board of directors to allocate time at a board meeting to discuss and approve including seller-favorable standstill provisions in non-disclosure agreements? Neither did we.

Happy New Year to you all and may 2014 bring us many more exciting M&A developments to discuss!

Where Are All the Women M&A Dealmakers?

By Diane Holt Frankle, Partner, Kaye Scholer LLP

I am that rarity—a senior woman M&A lawyer. I began my M&A career in the late 1980s as a corporate associate in a Silicon Valley law firm. Today I still live for the rush of deal adrenaline when a deal is coming together! I love being a trusted advisor to the board and management, and the quarterback for the negotiating squad. From the moment I managed my first deal I was hooked—I was and am a deal junkie. Maybe you are too?

As I looked around the negotiating table back in my early days in the M&A trenches, I certainly noticed the lack of other women on the deal teams—my clients had only a handful of women in decision-making roles, and there were very few women senior advisors back then. Still I was drawn to M&A as a discipline because deal work plays to many of my strengths, especially my ability to gain the trust and confidence of both the client and the other side, my skills in juggling, multitasking and successfully managing a team and a deal process, and perhaps most importantly, my empathy, listening and collaboration skills. I prefer to build consensus. While these traits aren't uniquely feminine, my unscientific and entirely anecdotal observations suggest that a high percentage of women deal professionals have these skills and use them effectively. This would seem to make us natural deal mavens, right?

So while there were very few women at the senior levels of deal making in the late 80s and early 90s, I certainly had expected that our ranks would swell over time. After all, I have managed the wicked demands of the deal work with family from the very beginning of my career. The day after I closed the first M&A deal that I managed from start to finish, I went into labor with my first son! Many women have learned like me to balance demanding jobs and parenting. We all stretch ourselves to participate in roles that matter most to us. There is no getting around the fact that dealmaking isn't for everyone, but I expected that by now the natural talents of women as deal makers would yield more women in senior deal roles.

Today, however, I don't see more women at the top of the deal than when I was launching my career, and my senior women colleagues in various law firms and investment banks tell the same story. Certainly there are more opportunities for women today. Every year our clients have more women senior executives, and women make up an ever-larger percentage of in-house legal and finance teams. Women are readily accepted as senior advisors, and I see little gender preference in deal staffing. That makes sense—key skills that women are often known for, like empathy, listening, collaboration, and considering multiple outcomes, are critical to making deals happen. And don't we all really want to get more deals across the finish line?

Ironically, while diversity is valued more and more by our clients, professional firms struggle to deliver a diverse team. The chances that I will be the only senior woman on a deal team are as high or higher now than when I started to lead teams in the late 80s. Recent surveys bear this out—for example, out of the 37 ranked Corporate/M&A lawyers in the most recent Chambers USA survey for Northern California, only 4 were women; in New York, out of 142 ranked lawyers in the same survey, women made up only 10! On the investment banking side the situation is even worse. We see few women at the table or coming up behind us in the ranks.

Of course, the scarcity of senior women deal advisors has nothing to do with the relative talent of women—rather it is the result of a diminishing talent pool at the senior levels. Women M&A lawyers and bankers have myriad choices as they advance and we have to face the fact that they are voting with their feet to leave the ranks of deal makers. As part of my own legacy, I have been brainstorming ways to fill the pipeline of women eligible to move into senior M&A advisor roles. How can we entice these women to stick around? I completely agree with Sheryl Sandberg's advice for women to "lean in," but while it is certainly necessary to change the mindset of our talent pool to consider the possibility of staying and succeeding, these talented women need reasons to stay. Here are three practical actions we can take today to increase women in senior M&A ranks:

> *First, make it clear to younger women that it matters to us all that they succeed.* Both men and women in the M&A deal ecosystem can be more intentional in making it clear to younger women that it matters to us all that they succeed. We can all make these women feel that they are valuable contributors and let them know that their retention matters. A personal welcome and message of inclusion is a powerful motivator. If more of us in the deal world gave

younger women a strong message that they belong in this "club," maybe more of them would stay when the going gets tough.

***Second*, direct more M&A deal flow to women advisors**. As more women business leaders have the power to direct business to deal advisors these women can make a point to support great women M&A advisors with deal flow. Guys have been supporting guys for years! Now women are in a position to give M&A deal work to trusted women advisors. This phenomenon will offer our young women one clear path to success, and thus another powerful motivation for these women to stay in the game.

***Third*, collaborate, build strong relationships and help one another succeed.** Women deal makers can do what comes naturally— form strong supportive relationships with other women and help one another succeed with referrals and other support. Since 2012, Jennifer Muller of Houlihan Lokey, Christa Fancher of SRS and I have cosponsored quarterly dinners for a group of senior women M&A professionals in Silicon Valley with an ever-expanding group of women professionals from all corners of the M&A ecosystem in our region. We have two simple goals—to make sure active women dealmakers know each other, and to find ways to support each other so that we can expand the pool and the opportunities to succeed. We are learning from each other ways to encourage our women coming through the ranks.

To steal a phrase, it takes a village to build a talent pool! Collaborating to expand both the pool of talented women deal mavens and our seats at the deal table will leave an important legacy. I look forward to this collaboration model expanding across the US. As I look to my crystal ball, I can see that 20 years from now there will be many senior women dealmakers driving deals. I can't wait to celebrate!

Modernization of Corporate Law in the Fly-Over States

By Phil Garon of Faegre Baker Daniels

When I attended law school and began practicing in the early 1970s, general corporate law and Delaware corporate law were pretty much synonymous. Most other states either patterned their corporation law after Delaware's or had unsophisticated corporate statutes with many significant gaps. The changes in non-Delaware corporation law in the last 40 years has been stunning, and, in certain respects, the Delaware statute has either not kept pace with more modern state statutes or has been amended to bring it into line with statutes previously enacted in other states.

In 1981, Minnesota adopted a new Business Corporation Act. Because the draft persons were unencumbered by an existing, well-developed statute of recognized stature, they felt free to adopt whatever provisions they felt were best for corporations and their shareholders. Their objective was to provide a comprehensive, flexible corporate statute. Some of the provisions of the new corporate statute, of course, were already in effect in Delaware, but the draft persons patterned many others after corporation statutes of other states or Model Business Corporation Act provisions and created several new provisions that enhanced flexibility or reflected developments in business and financing.

The Minnesota statute, for instance, eliminated the rigid, burdensome surplus test in effect in Delaware to determine whether dividends could be issued or stock could be repurchased, on the theory that a surplus test did not necessarily measure the likelihood that the corporation could pay its creditors after making those shareholder distributions. This also enabled them to discard outmoded concepts like "par value" and "capital." Instead, the Minnesota legislation provided for a more flexible and rational standard that permitted these distributions only if the Board determined that the corporation could pay its debts as they became due after making them.

The draft persons also eliminated the archaic concept of treasury shares applicable to stock that had been repurchased by a corporation. Under Delaware law, that stock presumably could be resold by a corporation without meeting any statutory standards applicable to new issuances of stock. Instead, the

Minnesota statute simply, and logically, provided that repurchased stock would again become authorized but unissued stock such that its "re-issuance" would be subject to the same standards as any other issuance of stock by that corporation.

Moreover, Minnesota's statute permitted non-directors to serve on Board committees to take advantage of the expertise of non-directors. It also permitted corporations, in their articles of incorporation or bylaws, to allow directors to vote by proxy if they could not attend a Board meeting.

Delaware did not revise its statute to eliminate the surplus test or the treasury stock concept. It still does not permit non-directors to serve on Board committees nor does it afford corporations the flexibility to allow their directors to vote by proxy.

In other respects, the corporation law of Delaware has followed, not led, the corporate law of other states. For instance, in 2004 Delaware broadened the consideration that could be paid in full for stock to include promissory notes and certain other consideration—more than 20 years after Minnesota and several other states did so. Delaware also finally amended its statute to permit transfer of assets to a wholly owned subsidiary without a shareholder vote even if they constituted transfers of substantially all assets. Moreover, it adopted limited anti-takeover legislation shortly after the adoption of similar legislation in several other states, including Minnesota, Wisconsin and Indiana.

Today, Delaware obviously remains the corporation law leader, and, of course, statutes of other states, including Minnesota, have been amended to include several provisions comparable to amendments previously enacted in Delaware. Nevertheless, it is with some pride that I am able to report that the virtual monopoly that Delaware had on sophisticated corporate legislation 40 years ago has been broken by lawyers and legislators in other states who in certain respects were more willing to eliminate outdated concepts, increase flexibility and reflect developments in the business and financial world.

Innovations in many areas are made by those who previously did not have the superior mousetrap. The area of corporate law is no exception.

A New Era for Management Compensation in Change-in-Control Transactions

By Michael Katzke & Henry Morgenbesser, Co-Founders of Katzke & Morgenbesser LLP

Over the last several years we have witnessed a significant retrenchment with respect to change in control-related benefits for management in the context of both public company severance arrangements and private equity treatment of management teams post-transaction. We do not sense that the pressures on management compensation from shareholder advisory groups, compensation committees and private equity sponsors will relent in the near future.

In this environment, it is important for advisors to senior executives and management teams to try to advocate as best they can to protect their clients, even if at times it is only at the margins.

In the public company context, pressure from ISS and Glass Lewis, two prominent proxy advisory service firms, and other shareholder advisory groups, have resulted in material cutbacks to provisions which were prevalent in change in control arrangements beginning in the mid to late 1980's and continuing up until the past two to three years.

Excise Tax Gross-Ups. The contractual gross-up payment for the 20% excise tax imposed under Sections 280G and 4999 of the Internal Revenue Code on golden parachute payments with a value that exceeds 2.99 times an individual's trailing five-year average W-2 compensation (a "280G Excise Tax Gross-Up") has become a rare provision to see in new change in control severance arrangements and has been eliminated by many companies from previously existing (and often longstanding) agreements (see Disney, among others).

Much more common now are provisions capping payments at the maximum level where golden parachute excise taxes would not apply (a "280G Cap") or providing for a so-called "valley" provision where the

executive is either subject to a 280G cap or receives the full uncapped payments, if he or she is better off on an after-tax basis by receiving all payments and paying the excise tax. In some cases, the agreement will provide that the executive must net at least 10% more on an after-tax basis compared to the 280G Cap amount in order not to be subject to the 280G Cap. We are of the view, however, that, under certain specific circumstances, 280G excise tax gross-up payments may be warranted.

For example, we have advocated for certain new hires that a gross-up provision should apply for a limited period of time (a "wear away" gross up), particularly where a chief executive officer or other senior executive is hired by the company specifically to help prepare the company for possible sale. Such individuals are more likely to be disproportionately impacted by a 280G Cap or valley provision in the event of a change in control transaction occurring soon after they commence employment.

One provision which has had increased scrutiny in this era of 280G Caps is the post-employment restrictive covenants applicable to executives who are terminated following a change in control. While we have often advocated against non-competition clauses following a transaction because the executive's position may be eliminated in mid-career and job flexibility could be paramount, carefully constructed restricted covenants may, for golden parachute excise tax purposes, support the position that a portion of the severance payment be treated as reasonable compensation (e.g., for services performed by the executive). Under such circumstances, payments made in consideration for the covenant may be exempt from the excise tax calculation under Section 280G and thus shield some of the compensation from the mandatory reduction which may otherwise result from a 280G Cap. This position will be enhanced for federal tax reporting purposes if the value of the non-competition restriction is determined by a reputable independent valuation expert.

<u>Single Trigger Severance.</u> Much like the criticism directed at 280G Excise Tax Gross-Ups, the ability for executives to terminate employment and receive severance following a change in control without the necessity of demonstrating a "good reason"/constructive termination event (often called a "single trigger contract") has come under heavy fire from shareholder advisory groups and, as a result, has become relatively rare, especially in new agreements.

While we believe such single trigger provisions may continue to have limited utility in keeping a management together for a period following a merger or other change in control transaction, we believe it is incumbent for the practitioner to focus carefully upon the "good reason"/constructive termination definition when such single trigger provisions are not included in a change in control employment or severance agreement. Aside from the typical "good reason" triggering events relating to reductions in base salary or target bonus opportunity or a significant geographic relocation, careful attention should be paid to other good reason triggers for certain corporate level executives (e.g., the chief executive officer, chief financial officer, general counsel and corporate secretary).

In particular, there should be a focus on whether such executives should be deemed to have "good reason" without further demonstration if they are no longer truly serving in their pre-change in control roles (or no longer have the same level of authority, duties or responsibilities even if they are, technically, still serving in the same roles) because (x) they are now employed at a subsidiary of a public company post-acquisition or (y) their operations or budgets are significantly slashed though ostensibly their duties or responsibilities remain the same. Most acquirers will not challenge such an executive's right to terminate for "good reason" when his or her position at their public company employer has been adversely affected as a result of the public company's acquisition resulting in a downshift of duties or responsibilities.

<u>Vesting of Equity.</u> ISS has pushed for modifying single trigger vesting of equity upon a change in control to double trigger (*i.e.*, change in control followed by a qualifying termination of employment) vesting and many companies have been compelled to follow the ISS recommendations and eliminate their single trigger vesting arrangements.

While we can appreciate the appeal of limiting the acceleration of vesting merely upon the occurrence of a change in control, we remain of the view that in many circumstances, vesting of equity upon closing of the transaction is wholly appropriate. In particular, we think cash-based transactions may warrant such treatment for executives, as do transactions which are true acquisitions (as opposed to mergers of equals or near equals) following which the performance of the management team of the acquired entity will have little impact upon the overall performance of the buyer.

Finally, we often see insufficient focus in plan documents on the treatment of unvested outstanding equity awards when a subsidiary or division is sold and employees in the spun-out business (who are often deemed terminated because they have ceased to be employed by the plan sponsor or any subsidiary thereof as

a result of the sale of their employing entity) have no contractual entitlement to having their outstanding equity awards rolled into the acquirer's equity plan (if any such plan exists). Many plans do not either automatically accelerate vesting upon such deemed employment terminations or specifically authorize the administrator of such plan to so accelerate if it deems appropriate. We believe that more careful consideration should be placed upon treatment of executives who are impacted by such a disaffiliation.

Private Equity Issues. Private equity acquisitions may present a different set of issues for a management team post-change in control. In such transactions, the private equity sponsor will typically present the management team with new employment agreements, rollover equity (usually on an after-tax basis) and new equity grants. We have found with increased frequency that private equity buyers are making it more difficult for management to achieve liquidity with respect to their equity or even vest upon good leaver departures.

While put rights for executives which would enable them to withdraw their equity upon an involuntary termination without "cause" or a termination for "good reason" are now generally not "market" in private equity transactions, we continue to believe this right is an important ask, particularly for rolled over equity amounts. Perhaps more importantly, the ability to vest in equity grants upon terminations without "cause" or for "good reason" is a key provision enabling executives to protect, in part, the value of equity granted to them pursuant to compensation packages which are typically heavily weighted these days towards equity grants.

While most sponsors will not vest performance-based equity in the absence of hurdles being met, there is a case to be made that time-based equity should have an accelerated vesting component. Although private equity buyers are very reluctant to provide for vesting of time-based equity to severed executives, we have pushed for pro rata vesting or acceleration of the next vesting tranche (e.g., a deemed additional year of service towards vesting), and at times have been able to obtain full vesting. Care must be taken in analyzing the entire proposed package to make sure management is not placed in the position, where they have rolled over significant amounts of equity (or the value thereof) from their acquired company and could be terminated from employment in year 1 for any reason whatsoever with no vesting of grants and no immediate liquidity on the vested rolled over amounts.

Our view of trends occurring over the past five or so years is that the market has significantly shifted to make it more difficult for management to immediately reap the aforementioned benefits upon a change in control, a practice had been widely criticized in past years. In gazing into our crystal ball, we do not see these restraints loosening in the near future. In our view, there is room for a balanced treatment in such transactions, where the interests of shareholder advisory groups, public company acquirers and private equity sponsors are mollified, while management is offered adequate protections for the value that they have created over time.

The Future of Mergers

By Martin Lipton, Founding Partner, Wachtell, Lipton, Rosen & Katz

A recent *New York Times Deal Book* article, "Frenzy of Deals, Once Expected, Seems to Fizzle," has resulted in a number of requests for me to discuss merger activity and predict the level of future merger activity. In the course of a long career of advising on mergers, I've identified many of the factors that determine merger activity, but a complete catalog is beyond me and I am not able to predict even near-term levels of merger activity. Since the 1980s, I've written and lectured extensively on this and the history of merger waves, and I regularly revise an outline of the factors that I believe are the most significant that influence mergers. This is a condensed version of the outline:

First, it is recognized that mergers are an integral part of market capitalism, including the types that are practiced in Brazil, China, India and Russia. Mergers are an element in the Schumpeterian theory of creation and destruction of companies that characterizes market capitalism.

Second, the autogenous factors, not in the order of importance, are relatively few and straight forward:

– Increasing revenue and profitability by product or geographic expansion, acquisition of talent and intellectual property or by increasing market power.

- Reducing costs by eliminating excess capacity and/or labor.
- Confidence of the management and the board of directors of the acquiring company that it can effectively integrate the acquired business.
- Ego and the desire for size and diversity without regard to profitability.
- A desire to remain an independent company and sense of responsibility to all stakeholders, (e.g., employees, customers, suppliers, creditors, and communities, as well as shareholders.

Third, the exogenous factors, again not in the order of importance, are:

- Availability of accounting conventions (principally those relating to depreciation and amortization) that enhance, or at least do not detract from, profitability.
- Pressure from activist hedge funds and lack of support from institutional investors to remain an independent public company seeking long-term creation of value.
- Government antitrust and competition policies.
- Availability of arbitrage to facilitate liquidity for securities that result from mergers.
- Foreign exchange fluctuations that make one currency "cheap" and the other more favorable as merger consideration.
- Regulation and deregulation and privatization and nationalization by governments.
- National policies to encourage "global champions" or to discourage foreign investment.
- The availability of experts in merger technology and in the creation of special merger currencies, such as contingent value rights and pay-in-kind debentures.
- Recognition of the legitimacy of hostile takeover bids and proxy fights and the availability of experts in the waging of hostile efforts to achieve a merger.
- Labor unions, government labor policies and the political and popular power of labor generally.
- The existence of private equity funds and the amount of funds that they have available for acquisitions.
- The state of the equity and debt markets and the receptivity of the markets and banks to merger activity.
- Litigation, shareholder and class actions designed to enjoin mergers or increase the cost.
- Taxes, tax policies and potential changes therein.
- Demographic changes.
- General business and political conditions.
- Technological developments, especially breakthroughs.
- Military research, military procurement and military policies with respect to suppliers and contracting.
- Trade treaties and the creation of trade and currency blocs of nations.

Lastly, it is recognized that the interrelation of all or some of these factors creates the permutations and combinations of issues that at any given time affect mergers and make it impossible to predict the level of future merger activity.

The Impact of the Internet on Deal Lawyering: Some Reflections

By Brian J. McCarthy, Partner, Skadden, Arps, Slate, Meagher & Flom LLP

There is little doubt that one of the most significant societal developments over the past two decades has been the rapid adoption and utilization of the Internet. It and its offspring (email, file sharing, website development, e-commerce, video and music streaming, among others) have impacted just about every aspect of our daily lives. For global enterprises, and the law firms that have followed them, innumerable efficiencies have been gained through the speed of communication and the ready connectedness of individuals, near and far.

For a U.S. law firm, communicating with clients or colleagues in Europe or Asia used to be a complicated ordeal. Remember the Telex? Law firms' stationery used to include a Telex address so that overseas clients could communicate with them. Now that space is reserved for Web addresses or social media sites.

In days gone by, when a client called to determine the status of the document *du jour* ("Do you have the employment agreement ready?"), you could quickly affirm that you were "focusing on it" without worrying about an expectation that you were to email the current version in the next 60 seconds. Having bought some time, you simply needed to ensure that the client's documents were completed in time to make the FedEx deadline (which you had taped to your desk—"Real FedEx deadline is 6:20 p.m. not 6:00").

Delivery of client documents sometimes took a small army. First, there was the actual document preparation followed by its final polishing ("Find all the instances where we said 'shareholder' and change them to 'stockholder.' This is a Delaware company not a California one!"). Then the document had to be copied, collated, stapled, and packaged with address labels to be handed to the overnight courier services, which sometimes took more than overnight. (At least one [illegible] had to recommence a tender offer because it didn't get its filing package to the SEC before the window closed on the scheduled start day). And in the days before FedEx tracking numbers, young associates often were asked to confirm that all of the deliveries had been made by placing calls to the recipients' assistants ("Mr. Smith won't be in the office for the next three days?").

Fond memories? Perhaps. But very quickly, we advanced from a world in which personal calls were the norm to one in which voicemails seemed to rule the workplace. This change was not without a struggle. I recall a partners' meeting debate that centered on whether a personal services organization, like a law firm, could really call itself a service firm if an automated message answered the phone versus a live person. Technology, industry practice, efficiency and cost savings (not necessarily in that order) resulted in the move to voicemail. Today, the phone rings a lot less while the frequency of communication has grown exponentially with people favoring email as the preferred method to contact lawyers. As a result, there is plenty of space capacity on my voice mailbox. (Contrast this to my two daughters, whose voice mailboxes are always full. I'm not certain they know this feature even exists).

Don't get me wrong. I love email (mostly). As a means for communicating and untethering oneself from the confines of a specific location, it has increased productivity immensely and, I would argue, helped to advance the speed of deal making considerably (although I am reminded of the adage of a wise client that said: "Deals bake in their own time").

Many articles have been written about email etiquette ("Beware of using all CAPS if you don't want to come across as HYSTERICAL") and the fact that it is a medium in which the absence of voice intonation and physical cues can result in misunderstandings.

Rather than fighting the daily barrage of emails ("I've got to get through these emails so I can get some work done"), I have come to embrace them. In many ways, the job of deal lawyers has become one of providing advice by responding to emails. In a world in which the sun doesn't always set on client needs, emails and reviewing and responding to attachments have increased the demands on lawyers' time and made work/life boundaries increasingly blurred.

In reflecting on the impact the Internet has had on our lives as deal lawyers, I would like to suggest a few items for consideration.

First, in deal making, do not underestimate the value of personal face time, and I don't just mean the Apple application. Being in a conference room together, sharing meals, engaging in inevitable small talk ("How 'bout those [fill in the name of your sports team]?"), all help to develop a common understanding and a comfort level that can engender trust. This can lead to a better appreciation of the needs and desires of a client and of the counterparty and can create an environment in which there is a willingness to go the extra step to get things accomplished. Almost every deal has a rough spot—a seemingly insurmountable "social issue" or perhaps a thorny tax issue. While often these can be solved by email exchanges or on the phone, I have found that there is a higher chance for a successful resolution if people have actually spent time together in person and put a face on the deal.

Second, the Internet inherently creates a "need for speed" and an expectation that people will (must!) respond quickly. Rapid responses without sufficient thought can be like candy: immediately satisfying but potentially unhealthy. Some of the best deal lawyers I know, many of whom are my partners, resist the urge to respond to a client's request for an immediate response when more time is needed for a considered answer ("Let me give that one some thought"). They take the time to think through the many possible implications of a response, frequently by discussing it with colleagues whose judgment they respect, just to ensure that the reply back reflects the *best* view, not just the quickest.

Finally, in many ways, the Internet has democratized the deal world. By providing greater access to deal documentation and analysis and commentary on deal developments and trends contained in law firm newsletters and client alerts and other sources such as the *Deal Lawyer*, a wider group of participants can become knowledgeable. This increased information is good for all since it can improve efficiencies and provide ideas for solving always-evolving client issues. But it is not a substitute for execution ability and deal judgment. It takes all of these attributes and more to be a successful deal lawyer.

One thing hasn't changed: the law is a service profession. The Internet has increased our ability to provide service to our clients, and further advances in communications will increase the demands on deal lawyering. Along the way, taking time to connect personally with the client and counterparties can have an immeasurable impact on the process, and even outcomes.

But if you'll excuse me, I have to get back to my emails.

Upcoming Webcasts on DealLawyers.com: Join us on January 30th for the webcast—*"How to Sell a Division: Nuts & Bolts"*—during which Bass Berry's Page Davidson, WilmerHale's Stephanie Evans and Kaye Scholer's Joel Greenberg will walk us through the nuts & bolts of selling a division.

And join us on February 26th for the webcast—*"The SEC Staff on M&A"*—to hear Michele Anderson, Chief of the SEC's Office of Mergers and Acquisitions, and former senior SEC Staffers Brian Breheny of Skadden Arps, Dennis Garris of Alston & Bird and Jim Moloney of Gibson Dunn discuss the latest rulemakings and interpretations from the SEC.

And join us on March 4th for the webcast—*"M&A Litigation: The View from Both Sides"*—to hear Robbins Geller's Randy Baron, Wilson Sonsini's David Berger, Grant & Eisenhofer's Stuart Grant and Morris Nichols' Bill Lafferty analyze the latest wave of M&A litigation that has permeated nearly all deals. This program features two lawyers from the plaintiff's side—and two from the defense perspective.

Important Trends in Cross-Border M&A for US Professionals: 1990-2013

By Phillip R. Mills, Partner, Davis Polk & Wardwell LLP

Since 1990, cross-border M&A activity has grown significantly in importance for M&A professionals. During the five year period 1990-1994, inbound M&A activity into the United States averaged just $50 billion per annum. In contrast, annual volumes since 2009 have averaged $220 billion, which itself is down from the peak of $320 billion per annum in the previous five-year period. Equally important are the trends which underlie the overall growth in inbound M&A volumes.

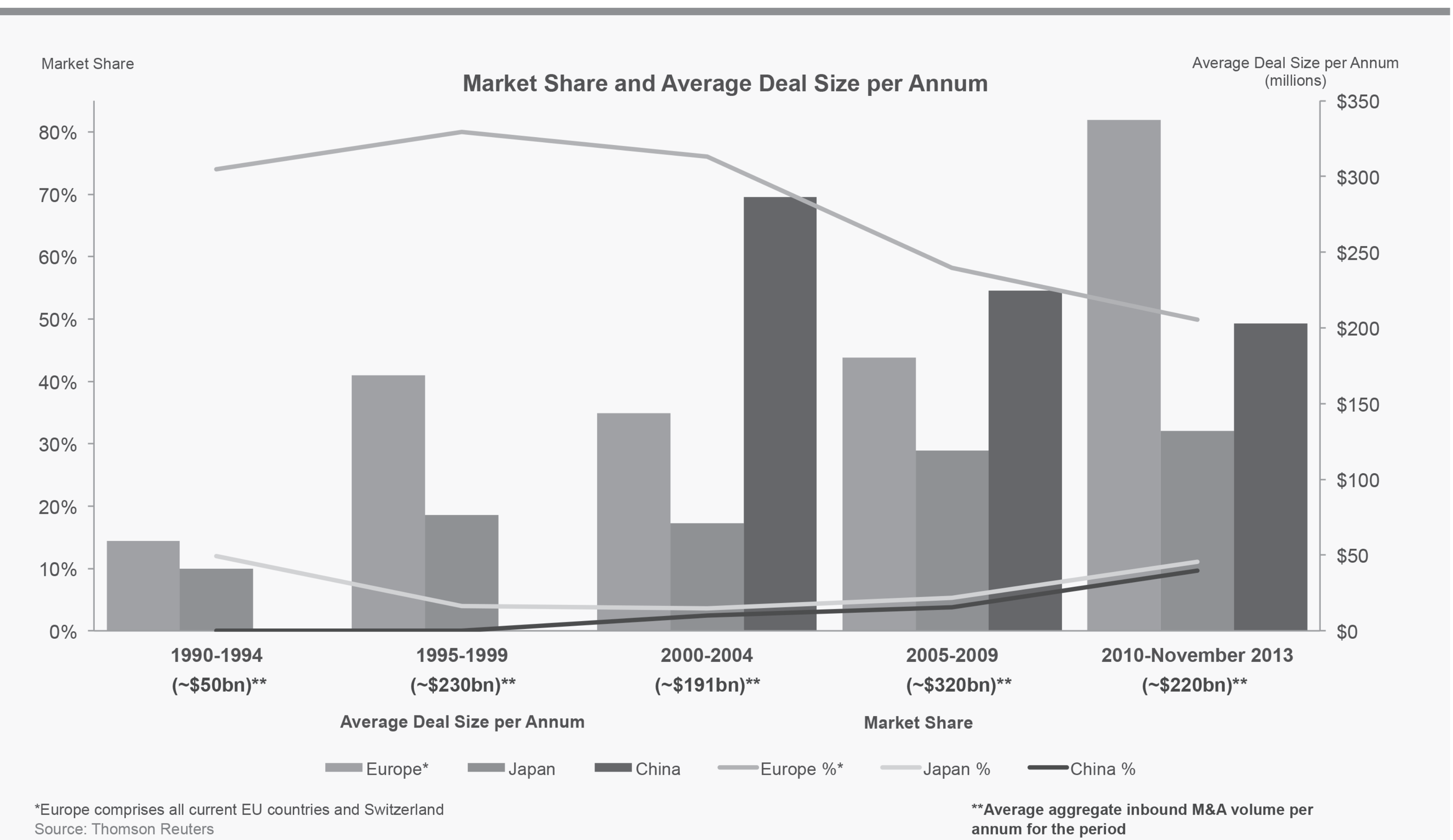
Although Europe remains the primary source of inbound M&A activity into North America, over the last decade Asia has become an important source as well. The market share represented by transaction volume originating in Japan has returned to levels last seen in 1990-1995. Most notable change is the emergence of China as a source of inbound M&A with significant transactions and growing volumes.

In 1995-2000, Europe was the source of 80% of inbound M&A volume into North America but European market share has declined to 50% in the last four years. Japan grew from 4% market share in 1995-2000 to 11% post-2009; and China went from de minimis before 2000 to 10% since 2009. Table A shows those trends along with the relative size of transactions emanating from those locations. From a US M&A lawyer's perspective, although a meaningful amount of the China-sourced M&A volume was into Canada (*e.g.*, acquisitions by China-based enterprises represented 5% market share of US inbound M&A volume since 2009 relative to 10% into North America), many of those transactions implicate US laws including national security laws (such as CFIUS review), antitrust laws and federal securities laws.

Despite the overall decline in Europe's market share of inbound M&A volume into North America, in absolute dollar terms Europe remains a very important source of US transaction activity. However, over the last decade Japan and China have come to rival most Western European countries in terms of deal volumes for US M&A transaction professionals. As shown in Table B, since the strong M&A environment of 1995-2000, each of the UK, Germany and the Netherlands have experienced declining market share of US inbound M&A transaction volumes; France's market share has been largely flat and Switzerland's share has grown. Looking at absolute dollar volumes though shows the importance of Japan ($[illegible] billion in average annual volume since 2009, which is larger than any European country except the UK) and China ($[illegible] billion in average annual volume since 2009, rapidly closing the gap with the major Western European countries).

Only a few law firms have the capabilities to properly service the needs of these diverse foreign acquirers. It takes a lot more than just having some transactional lawyers with appropriate language skills targeted at this space. It requires lawyers with depth of experience, cultural affinity, local law expertise (in particular, English and Hong Kong law in addition to US law) and in the appropriate scale in geographic proximity to the client and the locus of activity. It also requires teams with deep experience in regulatory issues—such as national security, anti-corruption, antitrust and securities laws—as well as M&A, corporate finance, tax, executive compensation and employment, and intellectual property legal and transactional issues. And it requires all of that talent to be aligned, committed and functioning seamlessly and across time zones in the best interests of the client and its strategic objectives, regardless of the familiarity the parties may or may not have with cross-border M&A.

Origin of Inbound North American Announced M&A Transactions (Table A)



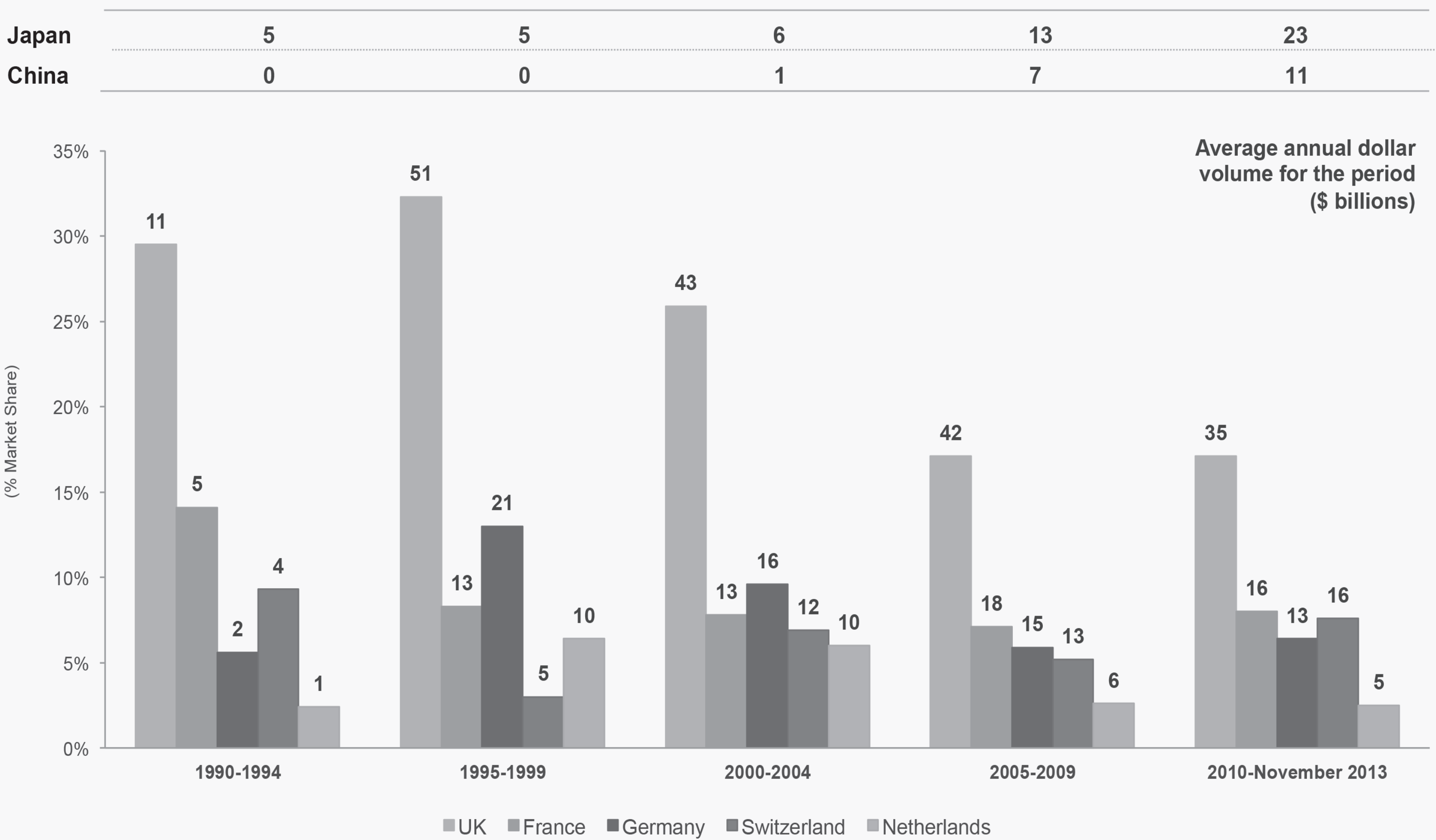
*Europe comprises all current EU countries and Switzerland

Source: Thomson Reuters

**Average aggregate inbound M&A volume per annum for the period

Inbound U.S. Announced M&A Transactions (Table B)

MARKET SHARE AND DOLLAR VOLUMES FOR SELECTED EUROPEAN COUNTRIES RELATIVE TO JAPAN AND CHINA



Source: Thomson Reuters

Special Negotiating Committees & the Delaware Bar

By A. Gilchrist Sparks, III of Morris, Nichols, Arsht & Tunnell LLP

Looking back upon 40 years at the Delaware corporate bar, one of the most significant and positive changes in the corporate governance landscape has been the development and use of the special negotiating committee to address corporate transactions involving a conflict of interest, in most cases with a controlling stockholder. Not only has the Delaware corporate litigation bench and bar played a major role in both encouraging and shaping this development, but also members of the Delaware corporate bar have frequently been called upon to serve as counsel to special committees and, in that capacity, to contribute to the development of special committee law and practice.

While there had been some use in the 1970s of the special negotiating committee concept, it was not until after the Delaware Supreme Court's landmark 1983 decision in *Weinberger v. UOP*[1] involving a cash-out merger of UOP, a partially-owned subsidiary, by The Signal Companies, its controlling stockholder, that the practice became commonplace. In *Weinberger*, the Supreme Court found that the parent company and its directors on the UOP board stood on both sides of the transaction and had not met the exacting entire fairness test applicable to such transactions. It then remarked, in what in retrospect must be considered one of the most significant footnotes in the history of corporate governance jurisprudence, that "the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length."

The Court went on to say that "a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness." From these few words, including the fundamental concept that the goal of a well-functioning special negotiating committee is to replicate to the extent possible an arm's-length negotiation, there has developed a large body of case law explicating both good and bad special negotiating committee practices. Further, the Delaware courts have fine tuned the effect to be given a well-functioning special committee process by not only accepting it as strong evidence of entire fairness, but also shifting the burden of proof on entire fairness from the defense to plaintiffs when a well-functioning special committee process exists.

Wholly apart from constituting a helpful process framework for courts to evaluate interested transactions and substantively moving in the direction of a level playing field between controllers and minority stockholders in conflict transactions, my experience has been that the process has had the collateral benefit of empowering independent directors who have experienced it and increasing their effectiveness and status in the boardroom after their service on a special negotiating committee is completed, and on boards of other companies upon which they serve. It can effectively transform passive directors into active, engaged ones.

Finally, a word or two about the Delaware bar's role in the special negotiating committee story. Because most Delaware law firms do not aspire to be outside general counsel to public companies, they are less likely than many larger out-of-state firms to have legal or business conflicts precluding their selection as special negotiating committee counsel. This, coupled with their repeated exposure to the special committee process both as litigators and advisors, make them prime candidates to fill the very important role of counsel to a special negotiating committee. As a result, Delaware lawyers have been frequent participants in the work of such committees, and no doubt will continue to contribute disproportionately to the development of this practice area.

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[1] *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

Other People's Money: The Evolution of Dealing with Financing Execution Risk in LBO & Strategic Mergers

By Robert E. Spatt, Partner, Simpson Thacher & Bartlett LLP

Having started my legal career in 1980, I had the pleasure of watching the modern M&A boom grow into a huge practice area, at the same time I was developing from a young inexperienced associate to a now grey-bearded practitioner. Those exciting 1980's also brought with it the birth of Private Equity—differentiating from strategic transactions in perhaps the greatest extent by the fundamental need for other people's money.

In those early years, from the 1980's to roughly 2005, the dichotomy between PE deals and strategic deals where one corporation bought another was reflected in large part in their approaches to financing conditionality. Generally, strategic buyers used their own balance sheet and did not have a "financing condition" enabling them to walk away from the deal if they did not have the money to close (except with very few exceptions where the acquisition might be very material relative to the size of the buyer), and the strategic buyer would be subject to specific performance requiring it to close the deal and be liable for damages if it did not close, based on a negotiated but relatively customary package of conditions. While the strategic buyer may well choose to obtain financing for the transaction, they had a high level of assurance in receiving it, and it was the buyer's risk to do so.

On the flip side, the classic PE model would have almost all purchase obligations be on a newly created shell company and acquire other people's money based on the credit of the acquired company to make the deal happen using a combination of equity from the PE firms' investors and debt placed on the target company at closing in a combination of bank loans and high yield bonds. While the deals would provide for specific performance, throughout this period the contracts had a financing condition relieving the PE purchaser from the obligation to close if the debt financing was not available at closing, premised on a recognition that without the other people's money, the deal just could not occur. Remarkably, throughout this period there were very few failures for deals structured this way to close as a result of financing, based in large part on the critical importance to the PE sponsors' reputation of getting the deals done.

In 2005, with the $11 Billion SunGard Data Systems sale to a PE consortium, the PE structure began to evolve away from the use of financing conditions. The target board there felt uncomfortable with the exposure and wanted something more. But with that change got ushered in a new paradigm for financial conditionality, but not necessarily less risk. In return for the elimination of the financing condition, the paradigm from 2005 to 2007 became no more specific performance against the PE buyer, and while the absence of the financing condition meant the buyer might be in breach of the purchase agreement if it could not close due to a lack of financing, the contracts effectively precluded <u>any</u> claim for damages other than the collection of a so-called reverse break-up fee of approximately 3 percent (generally reciprocal with the target company's fiduciary break-up fee), and the buyer entities were still shell companies backed by a limited guarantee of the PE sponsor to pay the reverse break-up fee if required.

While the impact of a financing failure would now carry a monetary cost, interestingly, in that early era, the remedy limitations and reverse break-up fee covered even non-financing breaches by the buyer, providing theoretical optionality to the buyer beyond just failure of financing. This would come to haunt sellers with the financial meltdown that occurred in late 2007/2008. That period experienced an unprecedented number of broken PE deals (at least 24). Oddly, while the failure of financing post-SunGard came with a stated cost, the presence of the reverse break-up fee effectively priced the optionality of the deal in the eyes of the players, and under the stress of that period, legitimized deal failures to a far greater extent than in the pre-SunGard era.

The intervening 5 years from 2008 saw the conditions for PE recover slowly with the first U.S. PE deal since the recession over $10 Billion not coming until 2013, when we saw both Dell and Heinz at around $20 Billion. The financing conditionality paradigm post-recession held relatively stable for PE deals, notwithstanding the deal dislocation during the recession and early expectations that sellers would demand much less conditionality. Today you generally see what we call the "financing failure model," where specific performance is available to enforce the financing covenants and, if the debt financing is available, to force the buyer to draw down the equity financing and close the deal. If financing is not

available, there is no right to specific performance but buyer will have to pay a reverse break-up fee—now generally at a significantly higher level than in the pre-recession period, with mean levels approaching 7 percent of equity value.

And what of the strategic buyer? Where have the corporations faired in all of this? In 2007 then Vice Chancellor Strine in Delaware questioned the dichotomy between PE and strategic deals in the use of reverse break-up fees and accompanying conditionality in the well-known *Topps Company* case. But instead of PE deals becoming more strategic as many thought at the time, some strategic deals have included financing conditionality and reverse break-up fees, particularly after the lessons of the post-2007 meltdown, with examples like Dow Chemical/Rohm & Haas.

In general, strategic deals remain for the most part "old school," i.e., with specific performance and full damages and no financing condition. When the [illegible] of the financing [illegible] for the acquired company is at a critical enough level, and a strategic buyer is willing to weaken the strength of its bid by including a financing condition of some type, then we will sometimes see a version of financing conditionality utilized in a strategic deal. Sometimes it would be a stated financing condition with a similarly sized fee triggered on its use, sometimes a PE-like financing failure model with a similarly sized reverse break-up fee. A non-comprehensive survey we have done of larger public strategic deals in the last 5 years shows about 13 percent of them having some form of financing optionality.

So, while the tension between the needs of buyers and sellers of necessity focuses on deal conditionality almost as much as deal value, the realities of financing and the variability of economic conditions always require us to be objectively responsive to the need for other people's money.

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This January-February issue is a special one, featuring some of the more prominent members of the M&A bar—tackling different topics as they look forward and looked back. The March-April will continue with this theme, as several more entries will be included in that issue. Looking forward!

A sister publication of the popular newsletter, *The Corporate Counsel*, *Deal Lawyers* is a bi-monthly newsletter for M&A practitioners to keep them abreast of the latest developments and analyze deal practices.

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