
GIBSON DUNN
M&A Hot Topics 2020
December 1, 2020

MCLE Certificate Information

- Most participants should anticipate receiving their certificate of attendance via email approximately four weeks following the webcast.
- Virginia Bar Association members should anticipate receiving their certificate of attendance six weeks following the webcast.
- **Please direct all questions regarding MCLE to CLE@gibsondunn.com.**

Panelists

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Andrew Kaplan is an associate in the New York office where his practice focuses on mergers and acquisitions, and corporate governance matters. Mr. Kaplan represents both public and private acquirors and targets in connection with mergers, acquisitions and takeovers, both negotiated and contested.

Agenda

State of Dealmaking
Lessons Learned from Broken Deals
Developments in Contract Provisions
Updates of Fraud
Representation and Warranty Insurance During the Pandemic
Current Issues in SPACs
Directors' Rights to Access Privileged Communications

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State of Dealmaking

Commentary on Dealmaking in 2020

A Wild Ride

- Strong start to the year, followed by a pandemic-induced halt and fears of catching a falling knife
- Dealmakers coming out of hiding
- A vibrant back-half

Adjustments to Deal Logistics

Looking Ahead

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Lessons Learned from Broken Deals

Impact of COVID-19: Deal Litigation and Renegotiation

The COVID-19 pandemic has resulted in an increasing number of transactions being challenged in litigation, or buyers seeking to renegotiate deal terms based on a vastly altered landscape

- **Common claims in buyer challenges include:**
  - Target has suffered a Material Adverse Effect (MAE) as a result of declined performance due to pandemic
  - If acquisition agreement contains a potentially applicable MAE carve-out, target has nonetheless suffered an MAE based on having been disproportionately impacted by pandemic
  - Target has breached covenant to operate in ordinary course of business between signing and closing, or to obtain required buyer consent to pandemic-related measures
- **Common claims in seller responses include:**
  - Acquisition agreement contains an applicable MAE carve-out
  - Buyer is seeking to avoid contractually binding obligations due to pandemic
  - Buyer is using pandemic to seek to extract better price or more favorable deal terms
  - Buyer failed to use reasonable best efforts to procure governmental approvals and / or otherwise to close the transaction

Examples of Litigated / Renegotiated Deals

Since the onset of the COVID-19 pandemic, a number of high-profile M&A transactions have been broken, litigated or renegotiated, including:

Realogy Holdings Corp. v. SIRVA Worldwide, Inc.

- SIRVA, a portfolio company of Madison Dearborn, agreed to acquire a subsidiary of Realogy for $400 million in November 2019; transaction financed with MD equity and third party debt
- In April 2020, SIRVA said it would not close on the basis of MAE; Realogy sued seeking specific performance

Result:

- Realogy case was dismissed. ECL automatically terminated upon Realogy brining claims against Madison Dearborn, except "Retained Claims" which did not include specific performance under the acquisition agreement.

Advent / Forescout

- On February 6, 2020 Forescout signed a merger agreement with affiliates of Advent for $33.00 per share, in a typical private equity structure.
- All cash transaction valued at $1.9 billion.
- Advent said it would not close on the basis of an MAE; Forescout sued for specific performance.

Result:

- On July 15, 2020, parties settled (five days before trial) at a reduced purchase price of $29.00 per share. Transaction closed on August 17, 2020.

L Brands / Sycamore

- On February 20, 2020, L Brands entered into a Transaction Agreement with affiliates of Sycamore Partners, pursuant to which Sycamore would acquire 55% of the Victoria's Secret business for $1.1 billion
- In April, Sycamore terminated the transaction alleging L Brands failed to operate in the ordinary course by closing stores amid the COVID-19 pandemic. Sycamore filed for declaratory judgment to validate the termination and L Brands countersued for specific performance.

Result:

- Parties mutually terminated transaction. No termination fees owed.
- L Brands announced plan to spin-off Victoria's Secret into a separate company.

How Can the Seller Protect Itself?

- **Material adverse effect carve-outs**
  - Epidemics, pandemics or outbreaks of disease (including COVID-19)
  - Without a "disproportionate impact" qualifier, or MAE to be evaluated only with respect to the incremental disproportionate impact
- **Interim operating covenant flexibility**
  - Discretion to operate the business in a prudent manner in light of pandemic circumstances
  - Specific carve-outs to protect health & safety, and comply with stay-at-home orders or similar legal directives
  - Remove requirement of buyer consent for non-ordinary course actions taken in accordance with pandemic needs
- **Buyer representations**
  - Buyer to acknowledge and agree to bear commercial risks associated with the pandemic
- **Termination rights and fees**
  - Potential extension of "Outside Date" provision, or inclusion of reverse termination fees, to account for governmental delays in issuing requisite approvals

Sellers can negotiate for specific acquisition agreement provisions to protect against buyer "outs" based on pandemic-related events

Final Thoughts

"I tell my wife all the time, 'Blame it on my third-tier subsidiary. It's a very limited guarantee you got.'"

HON. LEO E. STRINE, JR., Vice Chancellor

Transcript of Oral Argument and Ruling on Motion to Expedite at 80-81, Clear Channel Broad., Inc. v. Newport Television LLC, No. 3550-VCS (Del. Ch. Feb. 26, 2008)

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Developments in Contract Provisions

Contract Provisions

Areas of Focus

- Representations and warranties
- Definition of “material adverse effect”
- Interim operating covenants
- Access covenants
- Drop-dead dates

Representations and Warranties

- Absence of changes – “as of the date of the agreement” or brought down to closing
- Adequacy of the target company's IT systems and data privacy (in light of employees working remotely)
- Adequacy of the target company's emergency and disaster protocols and plans, policies and procedures for business continuity, and contingency plans
- Customer and supplier terminations, quantity reductions, supply chain risks and delivery delays, actual and anticipated defaults, insolvency risk, and material restrictions on the their operations
- Compliance with any governmental laws, orders, guidelines or recommendations related to COVID-19

Representations and Warranties (cont'd)

- Compliance with any COVID-19-related loan, or financial support, such as the Paycheck Protection Program loan under the CARES Act, the Economic Stabilization Fund loan or any other United States Small Business Administration loan
- Absence of undisclosed liabilities (e.g. increased costs to address the pandemic)
- Labor matters (e.g. labor shortage or workforce changes, including terminations, layoffs, furloughs, shutdowns or any changes to benefit or compensation programs and worker safety issues due to COVID-19)
- Adequacy of inventory
- Material contracts representations (e.g., whether counterparties have asserted force majeure claims)

Material Adverse Effect

Pre-pandemic

- Material Adverse Effect ("MAE") definitions routinely contained a carve-out for general economic, market or industry conditions, subject to a "disproportionate impact" exception to the carve-out
- MAE definitions sometimes contained a carve-out for *force majeure* events, natural disasters or acts of god, which (if included) were routinely subject to a "disproportionate impact" exception
    - More specific carve-outs for pandemics or epidemics were less common
- Dual-prong MAE definitions
    - Prong one, capturing MAE on the business and generally subject to carve-outs that make a traditional business MAE case difficult to make
    - Prong two, capturing MAE on the ability to the target to consummate the transaction / perform its obligations under the agreement and generally not subject to carve-outs

Aftermath of the Pandemic

- Uniform inclusion of explicit carve-out for pandemics, epidemics or similar health emergencies in the MAE definition
- Vast majority of MAE definition carve-outs list COVID-19 by name and some include language to pick up evolutions or mutations of COVID-19
- More pressure on dual-pronged MAE definitions

Interim Operating Covenants

- Pre-pandemic, affirmative interim operating covenants requiring the target to operate in the ordinary course:
  - sometimes went on further to say “in a manner consistent with past practice”;
  - were sometimes qualified by a commercially reasonable efforts (or other efforts) standard; and
  - often contained an exception for actions required by applicable law
- Interim operating covenants now frequently feature COVID-19 exceptions, but the exceptions are not uniform. Exceptions may include:
  - actions necessary to protect the health and safety of employees or others having business dealings with the company
  - actions to respond to third-party supply or service distributions caused by COVID-19
  - social distancing measures, office closures or safety measures adopted in response to COVID-19
  - actions taken in response to COVID-19 or certain authorized COVID-19 measures

Interim Operating Covenants (cont'd)

- Some agreements impose incremental obligations on the target in order to avail itself of COVID-related exceptions:
  - requirement to consult with buyer / consider in good faith the views of buyer regarding the proposed action
  - requirement that the action must be commercially reasonable
  - requirement that the action taken must be required by law or governmental order
- More recently signed deals may specify that ordinary course of business / consistency with past practice covenants include recent past practice in light of COVID-19 and/or actions taken in good faith in response to the actual or anticipated effects of COVID-19
- Some of these exceptions are addressed in schedules to the agreement

Access Covenants and Drop Dead Dates

Access Covenants

- Pre-pandemic, access covenants routinely required that the target provide the buyer with "reasonable" access to its properties, personnel and books and records, and were not qualified by an efforts standard
- COVID-related exceptions to the access covenant have been fewer
- Exception usually provides that physical access may be limited to the extent the company determinates in good faith that it would jeopardize the health and safety of its employees

Drop Dead Dates

- For deals that require regulatory approvals, government and regulatory agencies may have a longer review time period if government employees in the United States and abroad are forced to work remotely or work in shifts
- Parties may consider (i) a longer "outside date" or (ii) an automatic extension, but only if the relevant party has used applicable efforts to satisfy the relevant conditions

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Updates on Fraud

Overview

The core issue is whether an acquisition agreement *limits a remedy for fraud* against seller:

1. Solely with respect to *specific representations in the four corners of the agreement*; or

2. Also for *fraudulent information provided by the seller during negotiations* (e.g., in management presentations, a data room, discussions, etc.)

- General rule in Delaware: Without an express carve-out for fraud, an anti-reliance clause will preclude a claim for fraud on extra-contractual representations.
- Buyers routinely agree to anti-reliance disclaimers in M&A agreements. At the same time, buyers have increasingly demanded and obtained fraud carve-outs, which generally provide that various provisions of the contract apply "except in cases of fraud."
- Reliance disclaimers and fraud carve-outs, however, typically conflict as an anti-reliance disclaimer intends to exclude extra-contractual fraud claims that the fraud carve-out intends to preserve.
- In most acquisition agreements, claims for fraud are not subject to the negotiated indemnification limitations, meaning the ability to bring a fraud claim for extra-contractual fraud claims has significant consequences.
  - **E.g., what kinds of claims and what types of fraud are covered under the fraud carve-out?**

Key concepts from *Swipe Acquisition Corporation v. Krauss*, August 25, 2020

- In *Swipe*, the buyers' reliance on representations and warranties that the sellers did not have notice or knowledge of any major customers ending their relationships with the company was not disclaimed by the non-reliance clause in purchase agreement because the non-reliance clause allowed for reliance on representations and warranties within that section. The sellers found out, before closing, through a phone call that a major customer was ending their relationship with the company but actively concealed this fact from buyers.
- *Swipe* illustrates how an anti-reliance clause **did not bar a fraud claim** based on a representation **within** the contract that the sellers did not have notice or knowledge of any major customers ending their relationships with the company because the anti-reliance clause specifically permitted the buyers' reliance on representations and warranties within the agreement.
- Delaware law permits representations and warranties in a contract to form the basis for fraud claims even where a purchaser has **disclaimed reliance** on extra-contractual representations in the contract through an anti-reliance provision.
- Although a party cannot **"bootstrap"** a breach of contract claim into a fraud claim merely by adding the words "fraudulently induced" or alleging that the contracting parties never intended to perform, this bootstrapping rule does not preclude a fraud claim when contractual representations form the basis of a fraud claim and the plaintiff alleges facts sufficient to support a reasonable inference that the representations were knowingly false.

Nuances in anti-reliance provisions: *Infomedia Group v. Orange Health Solutions*, July 31, 2020

- By contrast, in *Infomedia*, the sellers learned over a phone call that a major customer was ending their relationship with the company. Despite this oral notice, the sellers did not disclose this to the buyers before closing, and even instructed employees not to disclose this information.
- However, the buyers' fraudulent misrepresentation claims failed due to an anti-reliance provision in the purchase agreement that expressly limited representations and reliance to **written notice** of customer terminations.
- Because the notice of the customer termination was over a phone call, the Court ruled that the claims were barred by the anti-reliance provisions and that the parties had bargained for the express written representations to **"define the universe of information that is in play for the purposes of a fraud claim."**

Fraud that follows… *Agspring Holdco LLC v. NGP*, July 30, 2020

- The Court ruled that buyers adequately pled a claim for fraud after the company defaulted on a material debt obligation even **three years after closing**. Buyers' claim for fraud was based on a clause in the purchase agreement that stated that sellers had no knowledge of "an event or an existing circumstance" that could result in a breach leading to default on a material contract.
- The Court found that buyers adequately pled a claim for fraud because it was reasonably conceivable that based on the company's steep financial decline before closing, events had occurred that would make it unmanageable for the company to avoid default, and the sellers not only **knew** this at closing but **affirmatively concealed** these enormous losses from the buyers before closing.

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Representation and Warranty Insurance during the Pandemic

Developments in Representation and Warranty Insurance

- At the beginning of the pandemic, when risks and impacts of COVID-19 were more unknown, insurers were broadly excluding RWI coverage for any breaches of representations and warranties linked to COVID-19.
- As insurers have grown more comfortable with COVID-19-related risks over the past months, they have been more willing to provide narrower COVID-19 exclusions on a case-by-case basis. In order to maximize their ability to obtain efficient RWI during COVID-19, RWI policyholders should consider several factors, including:
  - Carefully analyzing any RWI COVID-19 exclusions to ensure that they are clearly defined and seeking to ensure that these exclusions do not overlap with other important RWI coverage.
  - Carefully researching and performing due diligence on the impact and risks of COVID-19 on the transaction and the seller (e.g., industry effects, regulatory concerns, labor and employment changes) and being prepared to make a case to insurers for why certain COVID-19-adjacent risks should be included in the RWI coverage.

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Current Issues in SPACs

What is a Special Purpose Acquisition Company?

- Newly formed shell companies, with no revenue or operating history, that raise proceeds in an IPO for the purpose of acquiring one or more operating businesses
- Capitalized with investment from SPAC's sponsor and IPO proceeds, and post-IPO, sponsor owns 20% of SPAC's shares and private warrants, and public owns public shares and public warrants
- Sponsor investment "at risk" from and after closing of IPO
- Cash raised in the IPO is placed in a trust account and is not released until SPAC completes a business combination or liquidates
- Typically has 18-24 months to complete a business combination
- At time of business combination, public shareholders can redeem shares for their pro rata share of the funds held in trust. Sponsor not entitled to any cash from trust account if no business combination
- ***Key SPAC offering terms are relatively static and driven by market forces***
  - **Sector / industry focus**
  - **Public warrant coverage** (1/2 or 1/3 more typical with lower coverage for repeat sponsors)
  - **Public warrant terms** (e.g., ability to redeem and voting thresholds)
  - **Size of sponsor promote** (20% remains standard, though this may be shifting)
  - **Sponsor lock-up** (1 year post-business combination is standard)
  - **Sponsor loan** (loan repaid in cash or warrants at closing of business combination)
  - **Forward purchase arrangements**

Exponential Growth in SPAC Market in 2020

Through the third week of November, there were 193 IPOs raising more than $67bn in proceeds, as compared to 59 IPOs raising $13.6bn in 2019.

The value of the average business combination in 2020 has increased more than 70% to ~$1.5bn, as compared to $876m in 2019.

- **After record year, founders continue to explore SPAC IPOs**
  - Average IPO proceeds have grown by $120m from 2019
  - IPO terms tightened in October and November, with higher warrant coverage for public and private warrants
- **The rise of the "SPAC-off"**
  - Potential targets running SPAC-focused auctions as standalone process or alternative to traditional sale or IPO
  - Focus on SPAC sponsor's track record and expertise, operational expertise, marketing story and willingness to negotiate sponsor economics
  - Negotiation of comprehensive terms at LOI stage
- **Multiple potential roles for financial advisors, but also greater risk of conflicts of interest**
  - SPAC underwriters advise SPAC through IPO and business combination process
  - SPAC or target M&A advisors may also act as placement agent for SPAC's PIPE financing
  - Acting as capital market advisors for SPAC or target

Increased Focus on Sponsor Economics

- **Basic Structure** – Sponsor receives
  - 20% of outstanding shares in SPAC for a nominal investment (~$25,000) and
  - Private warrants in exchange for contribution of risk capital (~2% of IPO proceeds *plus* $2 million)
- **Adjusting sponsor economics in de-SPAC transaction**
  - Sponsor economics negotiated as part of overall de-SPAC transaction, and adjusted in roughly half of deals in 2020
  - Forfeiture vs. extended lock-up vs. earn-out
  - Reduces target shareholder dilution and provides an opportunity to align incentives
- **Sponsors increasingly exploring adjustments to promote structure at time of IPO, *but 20% promote remains market standard***
  - Pershing Square's sponsor took no shares in SPAC and deferred its private warrants
  - Health Assurance's sponsor reduced promote to 5% with additional "alignment shares" for post-close performance
  - SPACs disclose willingness to negotiate sponsor economics at time of de-SPAC transaction
  - Rationale that reduced sponsor economics make SPAC more attractive to potential targets and better aligns incentives
  - Counterpoint that sponsors already negotiate economics to align incentives, so primary benefit for IPO marketing
- **Trends to watch in the coming year**
  - Prioritize deal certainty by (1) disincentivizing redemptions at IPO and (2) backstopping redemptions in de-SPAC
  - Focus on sponsor deferrals and earn-outs, rather than forfeitures, with corresponding earn-outs for de-SPAC targets
  - Increasing adjustments to sponsor promote at IPO, but majority of IPOs retain traditional structure

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Directors' Rights to Access Privileged Communications

Privilege question resolved in: *In re WeWork Litigation*, August 21, 2020

- **Does management of a Delaware corporation have the authority to unilaterally preclude a director of the corporation from obtaining the corporation's privileged information?**
  - A recent decision by the Delaware Court of Chancery in the WeWork/SoftBank litigation addressed this question in the context of a special committee of WeWork's board of directors seeking privileged communications between WeWork, their in-house counsel, and outside counsel for the purpose of opposing WeWork's motion to dismiss a complaint that they brought on behalf of WeWork against SoftBank for breach of contract and breach of fiduciary duty.

  The Court held that directors are **presumptively** entitled to communications between management and company counsel **unless** there is a formal board process to wall off such directors or other actions at the board level demonstrating "manifest adversity" between the company and those directors.
- Management **cannot** unilaterally decide to withhold its communications with company counsel from the board (or specified directors management deems to have a conflict).

In re WeWork Litigation, August 21, 2020

This case reaffirmed that Delaware law is clear that consistent with the principle that the business and affairs of a corporation shall be managed by its directors, directors of a corporation have an "essentially unfettered" right to access legal advice rendered to the company or the board, with few exceptions:

1. An up front agreement limiting the scope of information available to a director.
2. A special committee is appointed and retains **separate legal counsel** in connection with its work.
3. The "manifest adversity" exception is available where **"sufficient adversity"** exists between different board members such that the directors whose interests may be adverse to the company "could no longer have a reasonable expectation that they were clients of [the company's] counsel." In prior cases in which the "manifest adversity" exception was recognized, the privileged was asserted either by the board of directors or a committee acting with the scope of its authority—not by management.
    - Management communications with company counsel can **only** be withheld from a director if the **board** first makes it clear to the excluded director that the corporation's interests are adverse to theirs and that such communications related to the adverse matter. Management **cannot unilaterally** make the determination of "manifest adversity" by itself.

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Upcoming Webcasts

- **December 2 | What's next? The Legislative and Policy Landscape After the 2020 Election** | 12:00 – 1:00 pm EST REGISTER

- **December 3 | The Paycheck Protection Program: Oversight of Existing Loans and a Look Ahead** | 12:00 – 1:00 pm EST REGISTER

- **December 8 | Congressional Investigations and Oversight Post-Election |** 12:00 – 1:00 pm EST REGISTER

- **December 8 | 2021 SEC Disclosures Outlook** | 12:00 – 1:30 pm EST REGISTER

- **December 9 | 2021 Proxy Season Outlook |** 12:00 -1:30 pm EST REGISTER

- **December 10 | International Anti-Money Laundering and Sanctions Enforcement** | 12:00 – 1:30 pm EST REGISTER

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Thank you for joining us!