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M&A Hot Topics 2022

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Panelists:

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MCLE Information
(60 Minutes Credit)

- Most participants should anticipate receiving their certificate of attendance in 4-6 weeks following the webcast
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Today's Panelists

Quinton C. Farrar is a corporate partner in the New York office of Gibson, Dunn & Crutcher. Mr. Farrar advises public and privately held companies, including private equity sponsors and their portfolio companies, investors, financial advisors, boards of directors and individuals in connection with a wide variety of complex corporate matters, including mergers and acquisitions, asset sales, leveraged buyouts, spin-offs, joint ventures and minority investments and divestitures. He also has substantial experience advising clients on corporate governance issues as well as in advising issuers and underwriters in connection with public and private issuances of debt and equity securities.

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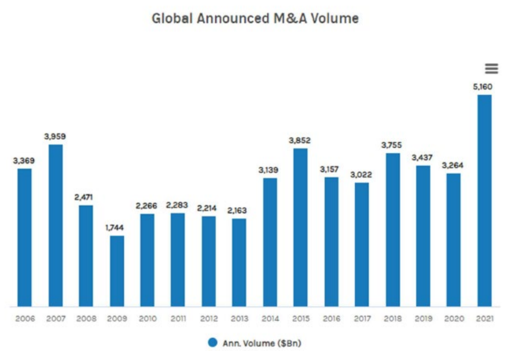
Trends in M&A and Private Equity M&A

Trends in M&A and Private Equity M&A

- **2021 was a record year for M&A generally**
  - More than $5 trillion in global M&A volume
  - Value of global announced M&A volume increased 58% from 2020, and number of deals also increased approximately 22%



Source: Refinitiv as of Jan. 3, 2022.

- **2021 was also a record year for private equity-backed M&A**
  - Private equity-backed M&A comprised 32% of global M&A volume, surpassing the prior record of 26% in 2020
- **Other trends**
  - More add-ons, more growth equity and more software private equity activity

Trends in M&A and Private Equity M&A

- **More buyer equity – increase in deals with buyer equity as a component of deal consideration**
  - 13% of deals in 2018, 15% of deals in 2019, 21% of deals in 2020, TBD in 2021

- **More earnouts – increase in deals with earnouts**
  - 13% of deals in 2018, 15% of deals in 2019, 19% of deals in 2020, TBD in 2021

- **Bigger earnouts – increase in size of earnouts as a percentage of closing payment**
  - 25% of closing payment in 2018, 39% of closing payment in 2020, TBD in 2021

- **Longer earnouts – elongation in earnout periods**
  - Fewer having a period of one year or less
  - More set to last two or three years
  - Median length of 24 months

Source: SRS Acquiom, May 2021, 2021 M&A Deal Terms Study

Forecasts for 2022

- **Forecasts for 2022 are bullish**
  - 92% of 1,300 executives at corps and PE investors expect deal volumes to increase or stay the same in 2022 (Deloitte, 2022 M&A Trends Survey)
  - 78% of 300 tech global dealmakers' expect M&A deal volumes to increase in 1H 2022 (MergerMarket)
- **Positives**
  - Growing U.S. GDP
  - Strong corporate earnings
  - Large corporate cash balances – more than $3.7 trillion of cash held by S&P 500
  - Large and growing private equity dry powder – more than $2 trillion of dry powder
- **Unknowns**
  - New variants of COVID-19
  - Interest rate increases and impact on financing costs
  - Increased scrutiny from antitrust regulators
  - Impact and viability of tax proposals

Fraud Claims

Fraud Claims

A seller can contractually seek to modify it exposure to a post-closing fraud claim by bargaining for limits on:

1. *<u>What</u> information the buyer is relying on*

2. *<u>When</u> the buyer may bring a claim*

3. *<u>Who</u> among the sellers may be held liable*

4. *<u>How much</u> the buyer may recover if it proves its claim*

Fraud Claims

<u>What</u> information the buyer is relying on

- Parties to a contract may contractually disclaim reliance on extra-contractual statements (non-reliance clauses), but a seller may not contractually limit its liability for making knowingly false statements within the contract itself ("contractual fraud")
  - Sellers should beware of a generalized fraud exception to non-reliance clauses and exclusive remedies provisions – the fraud exception should apply to contractual fraud only

<u>How much</u> the buyer may recover if it proves its claim

- Contractual caps for indemnification claims will not cap recovery for contractual fraud

A recent Delaware case, *Online HealthNow v. CIP OCL Investments*, addresses the "When" and "Who" limits on the right to prosecute a contractual fraud claim post-closing under Delaware law.

Fraud Claims

"When" and "Who" Limits

- **"When" Limits**
  - Survival clause cannot defeat contractual fraud claims
  - "Sellers cannot invoke a clause in a contract allegedly procured by fraud to eviscerate a claim that the contract itself is an instrument of fraud"
- **"Who" Limits**
  - Delaware courts will disregard non-recourse clauses where the parties purportedly insulated by those clauses were complicit in contractual fraud
  - A buyer can bring suit against the seller and its affiliates, even though the affiliates were not party to the agreement, if the affiliates allegedly actually knew of and participated in the fraud
  - A seller can potentially be liable for company reps
    - A seller's knowledge can result in liability

Fraud Claims

Defining Fraud

	Common Law Definition of Fraud	Negotiated Modifications
Covered Representations	• Any representation upon which the seller intended the buyer to rely	• Limit to representations in the agreement only • Exclude extra-contractual representations
Intent	• Seller knew the representation was false or made it recklessly without sufficient knowledge as to whether it was true or false	• Limit to intentional fraud • Exclude constructive fraud, equitable fraud, negligent misrepresentation or omission, recklessness
Inducement / Reliance	• Intent to induce a person's action or refrain from action, and that person acted (or refrained from acting) with justifiable reliance on the representation	• Add disclaimers that buyer did not rely on extra-contractual statements

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SPAC Fiduciary Duties:

In re MultiPlan Corp. Stockholders Litigation

In re MultiPlan: Background

- **July 2020**: Churchill Capital Corp. III (a SPAC whose sponsor was led by Michael Klein) announced a de-SPAC merger with MultiPlan, Inc.
- **September 2020**: Churchill filed proxy statement recommending stockholders approve the deal
  - Disclosed MultiPlan's dependence on UnitedHealthGroup, its largest customer, for approximately 35% of its revenue
  - Did not disclose UnitedHealthGroup's plans to develop an in-house data analytics platform, Naviguard
- **October 2020**: De-SPAC merger closed following approval of Churchill stockholders
  - Closing price of Churchill stock on the record date was $11.09 per share
- **November 2020**: Equity research firm published a report announcing that UnitedHealthGroup would launch Naviguard, which would allegedly compete with MultiPlan
  - The next day, MultiPlan's stock price dropped to a then-closing low of $6.27
- **April 2021**: Churchill stockholders filed suit alleging breach of fiduciary duty claims against the SPAC's sponsor, board of directors, CFO and financial advisor

The Court of Chancery's *MultiPlan* Decision

- **Key Takeaways**
  - The Court denied defendants' motion to dismiss on the basis that a "reasonably conceivable" impairment of public stockholders' redemption rights—in the form of materially misleading disclosures—had been pleaded
  - Entire fairness is the applicable standard of review on the following bases:
    - The de-SPAC merger was a conflicted controller transaction
    - A majority of the SPAC's board of directors was conflicted (i.e. directors were self-interested or lacked independence from Klein)
  - Stockholders' claims were direct, not derivative, claims
- **Observations**
  - The Court expressly noted that its analysis was guided by a "plaintiff-friendly" pleading standard and dismissal of a fiduciary duty claim under the entire fairness standard of review is "rare"
  - The Court focused on several alleged facts not present in every SPAC deal:
    - Klein, through his control of the Sponsor, was a controlling stockholder of the SPAC
    - Directors' compensation in the form of substantial interests in the Sponsor
    - Directors' lack of independence based on personal or employment relationships with Klein
    - Churchill hired Klein's advisory firm as a financial advisor for $30.5M fee

Looking Ahead: Unanswered Questions from *MultiPlan*

- Will entire fairness standard of review be applied to all cases involving de-SPAC transactions?
- Can plaintiffs make viable claims based on the economics of a SPAC and its sponsor that are adequately disclosed to investors?
- What procedural, price and/or other factors would result in a finding that the entire fairness standard was satisfied?
- What are the potential implications (if any) that *MultiPlan* will have on SPAC structures and deals?

Effect of Termination

Effect of Termination

- "**Effect of Termination**" provision in an acquisition agreement governs which provisions of agreement survive if agreement is terminated prior to closing
- Also frequently limits liability in the event of termination
- Careful consideration needs to be given on both buy side and sell side to ensure parties are entitled to their expected post-termination remedies and limitations on liability

In the event of termination of this Agreement as provided in Section 9.1, this Agreement shall forthwith become void and there shall be no liability on the part of either party (or any of its Representatives or Affiliates) except (a) for the provisions of Sections 3.23 and 4.5 relating to broker's fees and finder's fees, Section 5.10 relating to confidentiality, Section 5.13 relating to public announcements, Section 9.3 relating to the Reverse Termination Fee, Section 10.3 relating to notices, Section 10.6 relating to third-party beneficiaries, Section 10.7 relating to governing law, Section 10.8 relating to submission to jurisdiction and this Section 9.2 and (b) ***that nothing herein shall relieve either party from liability for fraud or any willful and material breach of this Agreement****, subject in the case of the Buyer to the limitations set forth in Section 9.3, 10.10 and 10.18.*

Effect of Termination

- **Defining Fraud and Willful Breach Standards**
  - As discussed, sellers frequently aim to limit post-termination claims for fraud to intentional fraud in making the reps & warranties in the contract
  - Consider defining the "willful breach" standard that would give rise to post-closing remedies, and whether the standard should encompass misrepresentations or only covenant breaches
    - Delaware courts have interpreted a "knowing and intentional" breach of an agreement as a deliberate act that in and of itself is a breach of the agreement "even if breaching was not the conscious object of the act."
    - *"**Willful Breach**" means (i) a material breach of any covenant or agreement set forth in this Agreement that is a consequence of an act or failure to act by the breaching party with the actual knowledge (as opposed to imputed or constructive knowledge or knowledge that could have been obtained after inquiry, or recklessness or negligence) that the taking of such act or failure to act would, or would reasonably be expected to, cause or constitute a material breach of such covenant or agreement or (ii) the failure of the Acquiror or the Company to effect the Closing if and when required pursuant to Section 2.2.*

Effect of Termination

- **Considerations on Limitations of Liability**
  - In transactions involving target company termination fees or buyer reverse termination fees, parties need to consider whether they expect such fees to serve as a cap or a floor on damages in the event of willful breach
  - Private equity buyers will typically seek to make the reverse termination fee the sellers' sole and exclusive remedy, including in the event of buyer's willful breach
  - Even in a competive M&A market with more private equity buyers agreeing to provide full purchase price "equity backstops" with no corresponding reverse termination fees for financing failure, such PE buyers are frequently seeking to cap monetary damages for breach (where sellers do not obtain specific performance)
  - Considerations may be different in transactions involving regulatory risk and termination fees payable for failure to obtain regulatory approvals

Antitrust

Antitrust

- **Change in Approach by Antitrust Regulators**
  - FTC and DOJ are focusing on a broader array of concerns, such as effects of transactions on employees and small businesses and other social impacts, and focusing more on vertical competition issues, which are relevant to supplier and customer combinations
- **Timing Impacts**
  - Suspended early terminations of the HSR waiting period
  - Time periods for completing second request reviews have lengthened from around 6 months to 9-10 months or longer
  - Nevertheless, due to the volume of deals requiring HSR review, the agencies are overwhelmed, and, consequently, they appear to be focusing limited resources on deals in key industries
  - "Pre-consummation" warning letter uncertainty
- **Industry Focus Areas**
  - Big tech, pharma, oil & gas, airlines
- **Remedies**
  - Prior notice and prior approval requirements

Antitrust

- **Practice Tips**
  - Expect a longer process and set a longer outside date
  - Consider, at the early stages of a transaction, in addition to traditional antitrust issues, whether there are other issues that create possible hurdles to antitrust clearance
  - If remedies are possible, address in the purchase agreement whether the buyer will agree to prior notice or prior approval requirements for future deals as a condition to obtaining antitrust clearance
  - Consider “ticking fees” and/or reverse termination fees if antitrust issues are likely
- **On the Horizon**
  - Rule-making by the FTC in the area of non-competes, and likely court challenges to that rule-making

ESG Considerations in M&A

Impact of ESG on M&A Transactions

- ESG has become a heightened area of focus for key constituencies of buyers and sellers (e.g., investors, employees and customers)
- ESG factors are becoming increasingly important in several key areas of M&A:
  - Selection of targets
  - Due diligence
  - Contract negotiation
  - Valuation
  - Financing
  - Post-closing integration
- Close attention must be paid to rapidly evolving ESG standards and disclosure requirements throughout the world

Conducting ESG Diligence

- **Areas of Focus**
  - ESG procedures, policies and frameworks
  - ESG disclosures and internal/external reports
  - ESG risks and synergies:
    - Regulatory compliance (e.g., anti-bribery, anti-corruption)
    - Litigation (e.g., environmental)
    - Governance (e.g., transparency, board matters, executive pay)
    - Supply chain management (e.g., product safety)
    - Labor matters (e.g., health and safety, employee misconduct, diversity and inclusion)
    - Data privacy and security
  - Mitigation efforts to remedy potential ESG exposure
- **Contractual Protections**
  – Representations and warranties (e.g. “me too” reps)
  – Indemnification

Thank You for Joining Us! – Today's Panelists

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