“Hot Topics” Webcast Covering M&A Issues

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GIBSON DUNN

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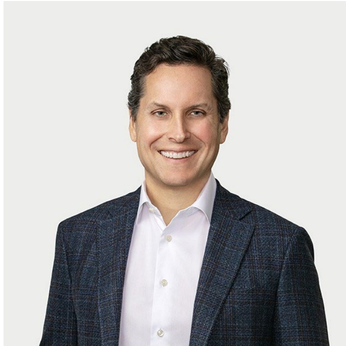
Today's Panelists

Robert B. Little



Robert B. Little is a partner in Gibson, Dunn & Crutcher's Dallas office, and he is a Global Co-Chair of the Mergers and Acquisitions Practice Group. Mr. Little has consistently been named among the nation's top M&A lawyers every year since 2013 by Chambers USA. His practice focuses on corporate transactions, including mergers and acquisitions, securities offerings, joint ventures, investments in public and private entities, and commercial transactions. Mr. Little has represented clients in a variety of industries, including energy, retail, technology, infrastructure, transportation, manufacturing and financial services.

Krista Hanvey

Krista Hanvey is co-chair of Gibson Dunn's Employee Benefits and Executive Compensation practice group and co-partner in charge in the firm's Dallas office. She counsels clients of all sizes across all industries, both public and private, using a multi-disciplinary approach to compensation and benefits matters that crosses tax, securities, labor, accounting and traditional employee benefits legal requirements. Ms. Hanvey has significant experience with all aspects of executive compensation, health and welfare benefit plan, and retirement plan compliance, planning, and transactional support.

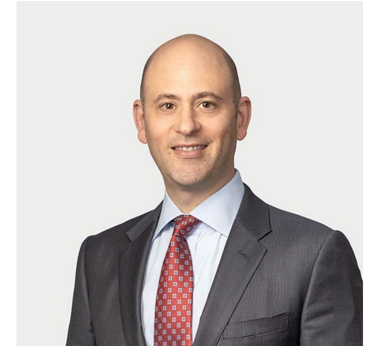
Evan M. D'Amico

Evan M. D'Amico is a partner in the Washington, D.C. office of Gibson, Dunn & Crutcher, where his practice focuses primarily on mergers and acquisitions. Mr. D'Amico advises companies, private equity firms, boards of directors and special committees in connection with a wide variety of complex corporate matters, including mergers and acquisitions, asset sales, leveraged buyouts, spin-offs and joint ventures

Kristen Limarzi

Kristen Limarzi represents clients in merger and non-merger investigations before the DOJ, the Federal Trade Commission, and foreign antitrust enforcers. Her experience in merger matters spans the gamut of sectors, including consumer products, healthcare, oil and gas, telecommunications, financial and other data services, transportation, and high tech products. Leveraging her prior experience as a top enforcement official in the U.S. Department of Justice's Antitrust Division, Kristen brings a practical approach to helping clients navigate the increasingly complex antitrust enforcement environment.

Douglas S. Horowitz



Douglas S. Horowitz is a partner in the New York office of Gibson, Dunn & Crutcher. Doug is the head of Leveraged and Acquisition Finance, co-chair of Gibson Dunn's Global Finance Practice Group, and an active member of the Capital Markets Practice Group and Securities Regulation and Corporate Governance Practice Group.

AGENDA

01 Hot-button purchase agreement provisions

02 Navigating the new landscape for non-compete covenants

03 Capturing stock premium-based damages in busted deals

04 Revised antitrust merger guidelines

05 M&A debt financing outlook for 2024 and its impact on deal-making

Hot-Button Purchase Agreement Provisions

01

Hot-Button Purchase Agreement Provisions:

Purchase Price Adjustments

Definitions

- Cash
  - Restricted cash
- Indebtedness
  - Employee-related liabilities
  - Prior acquisition true-up liabilities
  - Long-dated A/P
  - Other liabilities that are not “debt-like”

Calculation Principles and Methodology

- Impact of post-closing events or changes in circumstances

Dispute Resolution

- Arbitrator language
- Ability to change positions

Hot-Button Purchase Agreement Provisions:

Circular Indemnification

- In the case of a target that is an LLC, Sellers may have indemnification rights in their capacity as former members in the target LLC in connection with post-closing claims related to the transaction
- In the purchase agreement, Buyer typically agrees to maintain in effect the indemnification provisions in the target's organizational documents or D&O indemnification agreements
  - Under organizational documents and corporate law, a director or officer is entitled to advancement of expenses upon delivery of a customary undertaking
- If there is a claim by Buyer arising in connection with the transaction against Seller and/or individuals who were directors or officers of the target, Buyer could be required to indemnify Seller and/or advance expenses of the defendants
- To avoid this outcome, Buyers may propose several approaches:
  - Include a release by Sellers in the purchase agreement or in another document signed by Sellers
  - Limit the D&O indemnification obligation in the purchase agreement so that it does not apply to claims by Buyer arising in respect of the transaction – Issues with this approach
  - Limit the D&O indemnification obligation in the purchase agreement such that it applies solely to the extent of proceeds received under the D&O insurance policy – Issues with this approach
  - Include in D&O resignation letters or other separate documentation signed by the individuals a waiver and release of rights to indemnification for claims by Buyer arising in respect of the transaction

Hot-Button Purchase Agreement Provisions:

Financial Advisor Engagement Letter Terminations

- Financial advisor engagement letters are generally entered into between the target and the financial advisor
- The engagement letter provides for the payment of a transaction fee and expense reimbursement and includes indemnification rights in favor of the financial advisor
- At closing, it is not uncommon for Buyer to request a pay-off letter or possibly a termination letter from the financial advisor
- In the case of a termination letter, the financial advisor will insist that surviving obligations, such as the indemnification provisions, are not terminated
- Some Buyers react negatively to becoming responsible for an indemnification obligation in favor of the financial advisor that could become triggered in a claim by Buyer in respect of the transaction
- To avoid this outcome, some Buyers are insisting that the engagement letter either be terminated in its entirety or be assigned outside the target, but financial advisors do not like this approach
- Some sponsor sellers are agreeing to accept an assignment of the engagement letter
- Consider this issue on the front end when deciding which entity should sign the engagement letter

Hot-Button Purchase Agreement Provisions:

AI Representations

New representations for targets that use or rely on AI in a material way

The Company maintains or adheres to commercially reasonable policies and procedures consistent with standards in the industry relating to the ***ethical or responsible use of AI Technologies*** *at and by the Company, including policies, protocols, and procedures for: (a) developing and implementing AI Technologies in a way that promotes transparency, accountability, and human interpretability; (b)* ***identifying and mitigating bias in Training Data or in the AI Technologies used in the Company Products, including implicit racial, gender, or ideological bias****; and (c) management oversight and approval of the Company's employees' and contractors' use and implementation of AI Technologies (collectively, "Company AI Policies"). During the three years prior to the date of this Agreement, there has been: (i)* ***no material actual or alleged non-compliance with any Company AI Policies****; (ii) no material actual or alleged failure of a Company Product to satisfy the requirements specified in any Company AI Policies; (iii) no complaint, claim, proceeding, or litigation alleging that Training Data used in the development, improvement, or testing of any Company Product was* ***falsified, biased, untrustworthy, or manipulated in an unethical or unscientific way*** *and no report, finding, or impact assessment of any internal or external auditor, technology review committee, independent technology consultant, whistle-blower, transparency or privacy advocate, labor union, journalist, academic, or similar third-party that makes any such allegation; and (iv) no request from any Governmental Authority concerning any Company Product or related AI Technologies (except for requests that do not and are not reasonably expected to adversely affect in any material respect the Company's use of any Company Product or related AI Technologies), in each case of (i) – (iv), in any material respect.*

"AI Technologies" means any and all deep learning, machine learning, and other artificial intelligence technologies, including any and all: (a) proprietary algorithms, software, or systems that make use of or employ neural networks, statistical learning algorithms (such as linear and logistic regression, support vector machines, random forests, or k-means clustering), or reinforcement learning; and (b) proprietary embodied artificial intelligence and related hardware or equipment.

Hot-Button Purchase Agreement Provisions:

Interim Operations

Language changes are an outgrowth of the COVID era

Definition of Ordinary Course of Business

- Some definitions are introducing language around “unforeseen events”

  For the avoidance of doubt, any actions taken (or not taken) that are the reasonably prudent response to unforeseen or atypical events or circumstances shall be deemed Ordinary Course

  For the avoidance of doubt, any actions taken (or not taken) in good faith and reasonably necessary to comply with any Laws shall be deemed Ordinary Course

Interim Operating Covenants

- Some covenants to operate in the Ordinary Course of Business are subject to an efforts standard

Navigating the New Landscape for Non-compete Covenants

02

Navigating the New Landscape for Non-Compete Covenants:

Evolving State Laws

In addition to the outright prohibition of non-compete covenants (**California**, **Oklahoma**, **North Carolina** and **Minnesota**), many states now restrict the use of non-competes by:

- Implementing advance **notice** requirements
- Imposing **statutory time limitations** that restrict the permitted duration of covenants or the time period in which they may take effect
- Qualifying **which workers** may be subject to covenants

Employers must consider these recent statutory developments in order to ensure that their non-compete covenants remain effective. Evaluating a non-compete's scope and duration is no longer sufficient.

Navigating the New Landscape for Non-Compete Covenants:

Non-Compliance Can be Costly

- Non-compliant covenants are not simply **unenforceable**
- Some states impose **civil or criminal penalties** for seeking to enforce, entering into, or in some cases even presenting, a non-compliant covenant:
  - California – Up to $1,000 fine and up to 6 months imprisonment
  - Colorado – Actual damages and a $5,000 penalty/employees; Class 2 misdemeanor
  - Illinois – Up to $5,000/violation and $10,000/repeat violations
  - Virginia – Up to $10,000 per violation
- Some states have notice requirements about their laws
  - Virginia – Must post notices about the law with penalties from $250 to $1,000 for non-compliance)
  - California – Purports to void even contracts entered into out of state; Applies retroactively (notices required by Feb. 14) with fine of $2,500 per violation for non-compliance

Navigating the New Landscape for Non-Compete Covenants:

Federal Developments

Federal Trade Commission (FTC):

- Proposed a rule in early 2023 that would broadly ban non-compete agreements (unless in connection with the sale of a business).
- The proposal generated over 27,000 comments. FTC was initially expected to publish the final version by April 2024.
- Any final rule will face significant legal challenges.

National Labor Relations Board (NLRB):

- Issued a memo in March 2023 opining that nearly all non-competes with non-management workers constitute unfair labor practices.
- Although of no legal force, the memo underscores the growing trend of increased scrutiny of non-compete covenants.

Capturing Stock Premium-based Damages in Busted Deals

03

Capturing Stock Premium-based Damages in Busted Deals:

The *Con Ed* Framework

Buyers and Sellers historically have negotiated whether a target and its stockholders can recover "benefit of the bargain" damages (including lost premium) under the merger contract

Con Ed Decision:

- In *Con Ed*, the Second Circuit held that a merger agreement's blanket prohibition on third-party beneficiary rights deprived target-company stockholders of standing to sue the buyer for the lost share premium where a deal fails due to buyer breach

After _Con Ed_, three primary variations of _Con Ed_ provisions emerged:

(1) Expressly grant stockholders third-party beneficiary status

(2) Exclusive agency approach

(3) Damages-definition approach

Capturing Stock Premium-based Damages in Busted Deals:

Crispo v. Musk Overview

Background:

- In denying a shareholder's petition for a mootness fee in connection with Elon Musk's acquisition of Twitter, Vice Chancellor McCormick addressed a stockholder's ability to recover lost-premium damages
- Merger agreement provided that termination did not relieve buyers from liability for knowing and intentional breach, including liability for "the benefits of the transactions . . . including lost stockholder premium"
- Agreement also expressly disclaimed third-party beneficiaries

Analysis of *Con Ed* Provisions:

- Damages-definition approach unenforceable by target
- Damages-definition enforceable by stockholders if merger agreement (1) ***expressly*** confers third-party beneficiary status to pursue lost premium damages or (2) is deemed to ***implicitly*** confer such status
- Court noted that exclusive agency approach rests on "shaky ground," suggesting that a charter provision could designate the company as agent for stockholders in these circumstances

Capturing Stock Premium-based Damages in Busted Deals:

Con Ed Provisions After *Crispo*

Stockholders as express third party beneficiaries

- Provides leverage to target in busted deal scenario, but buyers will balk at increased risk of stockholder lawsuits

Target company as agent for stockholders

- Potentially viable despite court's skepticism that approach lacks "legal basis"
- Could be limited to situations where specific performance unavailable
- Where targets require stockholder approval, stockholders could be asked to approve appointment as agent, though this could create ambiguity for stockholders abstaining or voting against proposal
- Could be codified in the DGCL or addressed by future court decisions

Increase reverse termination fees to better approximate share premium

- Contracting parties cannot receive more than expectation damages, and deal premiums often far exceed a standard RTF as a percentage of deal value
- Court could determine that a fee is a penalty that has been structured to capture a lost premium

Remain silent on scope of damages with no third party beneficiary rights

- Willful and intentional breach (or similar standard) survives termination, but no specific reference to "lost premium" or "benefit of the bargain" damages
- Likely starting position for buyers, who will want to avoid increased exposure

Revised Antitrust Merger Guidelines

04

Revised Antitrust Merger Guidelines

- In December 2023, DOJ and FTC issued revised Merger Guidelines that describe how Agencies analyze the competitive impact of proposed transactions
- Revised Guidelines depart from the past 40 years of federal antitrust enforcement in at least two key respects:
  - Lower market share and concentration thresholds trigger presumption a transaction is anticompetitive
  - Reliance on novel theories of anticompetitive harm
- The Guidelines are not binding on courts—expect courts to diverge from the Guidelines, especially when they contradict precedent

Key Change:

Lower market share and concentration thresholds

- The draft Guidelines adopted substantially lower HHI thresholds, a tool the Agencies use to calculate industry concentration
  - **Prior Guidance**: 1500-2500 = “concentrated” and >2500 is “highly concentrated”
  - **New Guidance**: 1000-1800 = “concentrated” and >1800 is “highly concentrated”
- Under established precedent, mergers that increase concentration in “highly concentrated” markets are presumptively illegal
- New HHI thresholds would trigger this presumption at a substantially lower level of concentration than challenges in the past 20 years
  - No modern court has blocked a merger with an HHI less than 2739
  - Agencies rarely challenge mergers with HHIs less than 3000

Key Change:

Novel Theories of Harm

- Close scrutiny of transactions that may eliminate **potential competition**
- New framework for analyzing transactions involving **platforms** (companies that bring together two or more groups who benefit from each others' participation)
- Analyzing combinations that may potentially harm rivals of the merging parties in non-horizontal or non-vertical contexts
- Attention to **serial "roll-up" or "bolt-on" acquisitions**
- Increased scrutiny of the effect of transactions on competition for workers or **labor markets**
- Framework for analyzing whether transactions create or enhance **monopsony effects** (i.e. buyer power)

Potential Implications and Responses

Key Take-aways

- **Burdensome Investigations:** Guidelines signal deeper and broader investigations than before, covering labor and prior transactions
- **Less Judicial Deference:** Guidelines' overreach may result in less favorable treatment by courts long-term.
  - ***Net effect: Less deal certainty and increased procedural delay***

Strategies for Parties

- **Prepare for antitrust review early**:
  - Involve counsel to ensure transaction and strategy documents are not ambiguous or subject to misinterpretation
  - Build investigation time into termination outside dates
  - Consider enforcement environment when apportioning risk in agreements
- **Include antitrust team early to get head-start on process**
  - Develop strong advocacy and potential remedies to "litigate the fix" or discourage lawsuits
- **Prepare to litigate in challenging cases**

M&A Debt Financing Outlook for 2024 and its Impact on Deal-making

05

M&A Debt Financing Outlook for 2024 and its Impact on Deal-making

Current trends in highly levered acquisition finance

- **Large Cap Transactions**
  - Private Debt vs. Syndicated Solutions vs. Pro Rata Bank Markets
  - Loans vs. Bonds
  - Portability when possible
  - Junior Capital
- **Middle Market Transactions**
  - Private Debt vs. Pro Rata Bank Markets
  - Preferred Equity
- **Capital Structures**
  - Leverage Levels
  - Minimum Equity Conditions
- **Implications for Carve-outs**
- **Maintenance Covenants**
- **Rate Hedging**

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