WHITE & CASE

Reality check: US M&A H1 2022

US deal activity saw an annual decrease in H1 of this year, but remains buoyant compared to pre-pandemic standards

M&A proves its resilience after a year of excess

US M&A deal levels remain robust, despite dropping from historic highs set in 2021

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US M&A activity eased off in the first half of 2022 following an annus mirabilis for US M&A in 2021. Total value slipped to US$995.3 billion, a 29 percent year-on-year fall, though this is consistent with dollar volumes seen before the pandemic and so remains healthy by historic standards. Deal volume also fell, by 21 percent to 3,818 transactions. While this also remains above average, there was a material softening in the frequency of deals moving through Q2, which saw a quarter-on-quarter drop of 22 percent to levels last seen in Q1 2020, when the market was just beginning to recover from the initial shock of the pandemic.

A lot has happened this year to test acquirers' nerves. Inflation concerns had already begun to set in before the war in Ukraine started. The conflict catalyzed further unease in capital markets as well as exacerbated supply chain troubles which have, in part, contributed to inflationary pressures. The S&P 500 officially entered a bear market in mid-June, and the Federal Reserve has embarked on a monetary tightening program to bring prices under control, leading to an increase in financing costs.

Regulations are another consideration. The SEC has taken the SPAC market to task, proposing accountability for deal parties and intermediaries for inflated projections. This type of transaction ground to a standstill in Q2 this year, as participants digested their risk exposure and the implications of the regulator's proposals weighing on overall M&A volume. More recently we have seen some truly innovative SPAC structures that have the potential to re-stimulate interest in these deals.

For the most part, the US M&A market has stood up impressively to everything that has been thrown at it, which alone is solid grounds for optimism. Despite technology stocks being sold off heavily in equity markets, the sector has once again outperformed on the M&A front as companies and PE sponsors, who remain heavily armed with dry powder in spite of the more challenging deal financing conditions, continue to be attracted to innovation.

The fall in price-to-earnings ratios in the public markets and EBITDA multiples in private markets mean that, all else being equal, acquisitions are more attractive today than they were a year ago. Naturally, investors remain cautious as they closely watch how inflation plays out, the Fed response and the impact of those actions on underlying economic growth. However, the second half of 2022 has the potential to reclaim some of the confidence lost in recent months.

Contents

US M&A settles back down

Deal value in the first half of 2022 could not match the record-breaking level of activity in 2021

By Michael Deyong and Gregory Pryor

The headline for the first half of 2022 is that US M&A markets are still remarkably healthy, despite a confluence of headwinds. Without question, 2021 was an exceptional year, fueled by pent-up demand, historic levels of liquidity and an explosion of de-SPAC activity. The S&P 500 rallied to new highs and debt financing was in abundance, arguably overabundance.

Some deal fatigue set in as markets peaked in Q4. This year so far has experienced an ebb to a more sustainable flow of activity but, importantly, aggregate M&A value still remains above pre-pandemic levels. A continuation of 2021 was never realistic, and the US M&A market is now moving at a more rational pace as equity markets trend back down from the adrenalized run witnessed from mid-2020 through 2021.

US $995.3 billion

The value of US M&A deals in H1 2022—a 29% decrease compared to the record highs seen in H1 2021

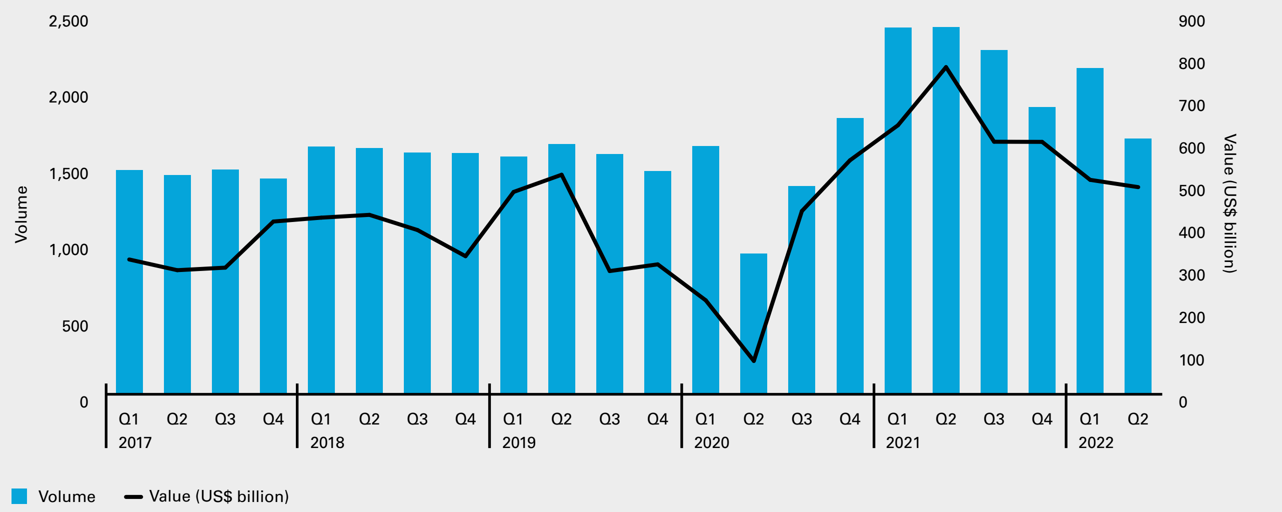
There was US$995.3 billion worth of deals in H1, down 29 percent on the record US$1.4 trillion in the same period last year. Mitigating for the impact of the pandemic, this year's performance almost exactly matches that of H1 2019 (US$996 billion). This comes with a caveat. There was a relatively sharp drop-off in the volume of deals made in the second quarter.

While still following a high trend line, there were 22 percent fewer deals in Q2 versus Q1 (1,677 and 2,141, respectively). For perspective, the fall in volume between Q1 and Q2 2020, which captures the initial impact of the COVID crisis, was 43 percent. This is something to keep a close eye on as the year progresses.

Changing conditions

The current environment presents a number of challenges. Post-pandemic growth is faltering, as inflation bites and the Federal Reserve has set out a path of monetary tightening that includes

US M&A 2017 – H1 2022



Top-ten US M&A deals H1 2022

Announced date	Target company	Consolidated sectors	Bidder company	Bidder-dominant country	Deal value US$(bn)
18/01/2022	Activision Blizzard, Inc.	TMT	Microsoft Corporation	USA	75.1
26/05/2022	VMware, Inc.	TMT	Broadcom Inc.	USA	71.6
14/04/2022	Twitter, Inc. (91.24% stake)	TMT	Elon Musk (Private Investor)	USA	41.3
10/05/2022	Duke Realty Corp.	Real estate	Prologis, Inc.	USA	27.9
31/01/2022	Citrix Systems, Inc.	TMT	Vista Equity Partners Management, LLC; Evergreen Coast Capital	USA	16.6
04/05/2022	Black Knight, Inc.	TMT	Intercontinental Exchange, Inc.	USA	15.5
29/03/2022	Nielsen Holdings plc	TMT	Brookfield Business Partners L.P. ; Evergreen Coast Capital	Canada	15.3
28/02/2022	First Horizon National Corporation	Financial services	TD Bank Group	Canada	13.4
19/04/2022	American Campus Communities, Inc.	Real estate	Blackstone Property Partners; Blackstone Real Estate Income Trust, Inc.	USA	13.1
10/05/2022	Biohaven Pharmaceutical Holding Company Ltd. (97.41% stake)	Pharma, medical and biotech	Pfizer Inc.	USA	11.6

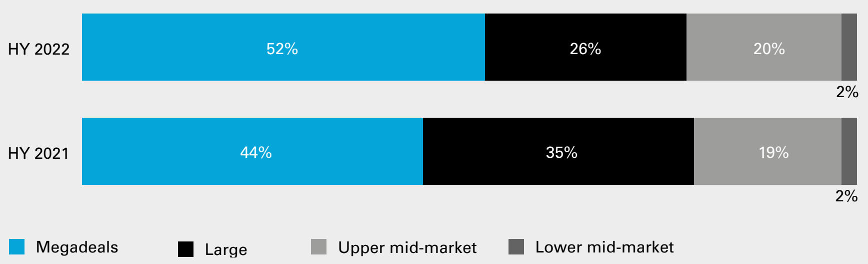
both rising interest rates and the shrinking of its balance sheet, reversing the historic quantitative easing that sought to stabilize markets and backstop the economy.

M&A markets showed signs of softening as the year progressed. However, there have been some exceptionally large plays among corporate buyers. These transactions reflect the willingness of these parties to follow through on their strategic priorities and look past today's short-term macro-volatility.

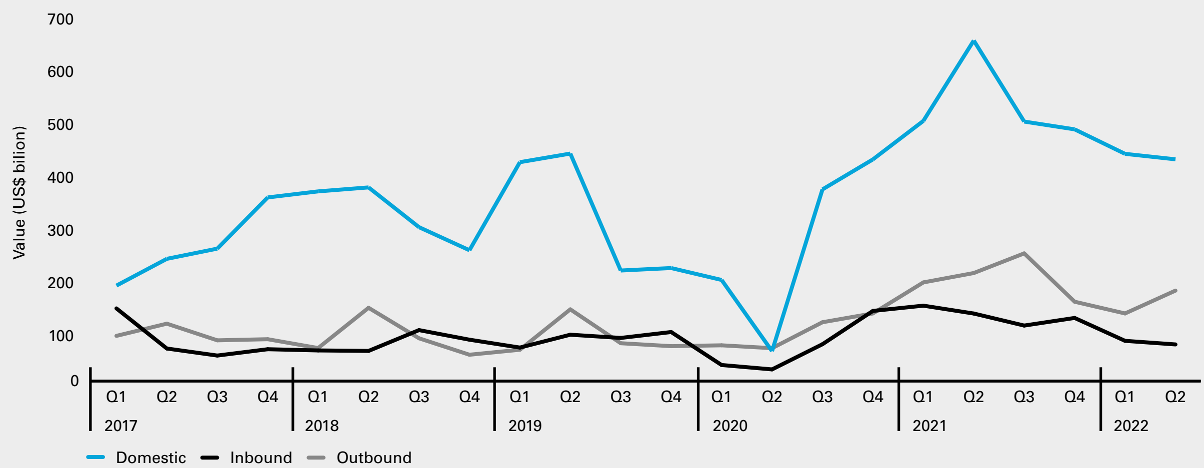
Private equity has been remarkably consistent, considering the circumstances. Across the first half, sponsors represented 42 percent of all US M&A value, consistent with last year (41 percent). The industry has also held its own on a volume basis.

Financial sponsors are nonetheless more exposed to the

US M&A value by deal size H1 2022 vs. H1 2021



US M&A: Domestic, inbound and outbound value



higher-rate environment than their corporate peers.

Rates may not be high on a long-term historical basis, but what counts here is the pace of change. As recently as February, the Federal Funds Effective Rate was a mere 0.08 percent. By June, it was 1.21 percent. Although this is still quite a low rate in absolute terms, it represents a more than 1,400 percent increase in relative terms—the sharpest rate of change in at least six decades.

Spreads are widening as debt investors demand a higher risk premium. This is felt most acutely in the leveraged finance markets. The higher cost of financing for PE dampens the attractiveness of exit bids.

The silver lining here for PE amid higher debt costs is that EBITDA multiples have compressed. Private equity still has piles of dry powder sidelined, even if funds may be required to write higher-equity tickets in the near term than they are accustomed to.

Strategic edge

Short term, this puts companies at an advantage. Although PE generally has a higher risk tolerance, corporate buyers have the capacity to pay a premium owing to their strategic rationale for deals and synergies. In an uncertain environment, PE can walk away from heavily

Recent tax reform

By Scott Fryman

With Biden's signature Build Back Better legislation hitting roadblocks in 2021, talks of a tax reform overhaul were widely written off, until the surprising development involving the Inflation Reduction Act of 2022, which was recently passed by the Senate and the House, and is expected to be signed by President Biden in short order. The act revives parts of the tax legislation proposed in Build Back Better as part of a larger bill also addressing energy, climate, healthcare and prescription-drug policy. As a reconciliation bill, Senate Democrats were able to avoid a Republican filibuster and pass the act with a simple 51-vote majority.

In particular, the new legislation includes a 15 percent corporate minimum tax on corporations with average applicable financial statement income in excess of US$1 billion during a three-year (or in certain circumstances, shorter) measurement period. Note that this is separate from the 15 percent worldwide minimum levy deal that Treasury Secretary Janet Yellen, together with her counterparts abroad, are lobbying to enact in more than 130 countries, which has not gained traction in Congress.

In addition, the bill provides for a one-percent excise tax on the fair market value of certain stock that is "repurchased" during the taxable year by publicly traded US corporations. The value of stock repurchased is reduced by the fair market value of certain stock issuances throughout the same year.

A prior version of the bill had extended the current three-year holding period required to achieve favorable long-term capital gain treatment for carried interest payable to private equity fund managers to five years, subject to certain exceptions. This proposal was ultimately dropped in the final version in exchange for the one-percent tax on buybacks.

Significant guidance from the IRS and Treasury will be necessary, and is expected, to administer the new tax legislation. For example, the buyback tax currently has broad applicability, and the statute grants the Treasury express authority to "address special classes of stock and preferred stock." Many public corporations, and in particular US SPACs, where shareholders have the option to redeem their shares in connection with a business combination, will be looking to the IRS and Treasury for greater clarity as to the scope of these rules.

ESG: Decarbonization goals shape US dealmaking

By Seth Kerschner

Fueled by investor, consumer and regulatory pressure, decarbonization has become a central component of business strategies across the globe. As such, it is now a major driving force behind US dealmaking, and it is rare for parties in an M&A transaction to not have a commitment to strengthen the global response to climate change threats and support a just energy transition. Nor are environmental, social and governance (ESG) issues seen only as a risk mitigation exercise when it comes to M&A—instead, businesses are increasingly seeing it as an opportunity to create value.

One such example is Tier Mobility's acquisition of electric bike and scooter operator Spin, which marks the European shared micro-mobility provider's expansion into the US. Through initiatives such as modernizing the Spin fleet with 100 percent swappable batteries, the partnership aims to improve environmental sustainability in the US micro-mobility industry.

Greenwashing is top concern

Yet, a lack of defined standards regarding how businesses can make claims concerning the environmental benefits of their operations and products is still a key concern for businesses. Nevertheless, companies must be able to substantiate their environmental benefit claims with objective data and analysis.

Within this context, environmental diligence has taken on a whole new level of importance in the dealmaking process. Buyers need to gain an understanding of the integrity of their deals—if it cannot be proven, it runs the risk of attracting regulatory scrutiny.

Regulation on the rise

In March of this year, the SEC proposed new rules requiring more extensive disclosure of climate-related information in its SEC filings. In May, it proposed further regulation seeking to standardize disclosures related to ESG factors considered by funds and advisors.

The SEC's new requirements would require integration with a public company's internal controls and audit functions. Nevertheless, litigation challenging the SEC's authority is likely if the proposed rules are adopted.

competitive auctions since it has more optionality.

However, regulation is playing a major role in deal outcomes. The very largest corporate acquisitions are typically global and carry considerable antitrust risk. The largest deal of Q2 was a US$71.6 billion tie-up between chipmaker Broadcom and cloud software business VMware, two US companies. The transaction is currently subject to a lengthy antitrust investigation by the EU and it could be a year before the deal closes.

The Biden administration is similarly committed to increasing antitrust enforcement and that commitment shows no signs of wavering, especially given the relevance of preserving competition and curbing further rises in consumer prices amid decades-high inflation.

Turning to the second half of 2022, we anticipate that in the coming months volume may continue at the same pace as it did in Q2, especially factoring in the summer lull. Toward the end of the year, markets should have digested the brunt of the interest rate change and inflation will by then hopefully be coming under control, improving consumer sentiment and investor confidence. No one can predict the future; however, US M&A has so far shown considerable resilience in the face of adversity and appetite remains strong, as acquirers double down on their due diligence and take the long view.

Private equity firms battle headwinds in H1

Despite facing economic and regulatory hurdles in H1, PE dealmaking remains resilient, and looks set to reach its second-highest value on record

By Oliver Brahmst and Luke Laumann

In line with overall M&A activity, US PE dealmaking in H1 lagged behind 2021 in terms of both value and volume. Total deal value of US$415 billion during the first half of the year represents a 28 percent fall year-on-year—yet this level of activity looks on track to reach the second-highest annual deal value in Mergermarket's history (since 2006), after the record-topping 2021.

A deal volume of 1,727, while 20 percent below the 2021 total, is still firmly ahead of pre-2020 activity levels. This resilience proves that a new level of US PE dealmaking is being set in the post-pandemic era.

US $415 billion

The value of US PE-related deals in H1 2022

A tougher macroeconomic climate

PE firms have managed to achieve this level of activity despite more challenging macroeconomic conditions, with rising interest rates making it increasingly difficult to agree on valuations. Tighter monetary conditions also mean that GPs are finding financing more difficult for their buyouts. When facing economic headwinds, PE firms are also more likely to extend their investment periods, which may cause a slowdown in the exit market.

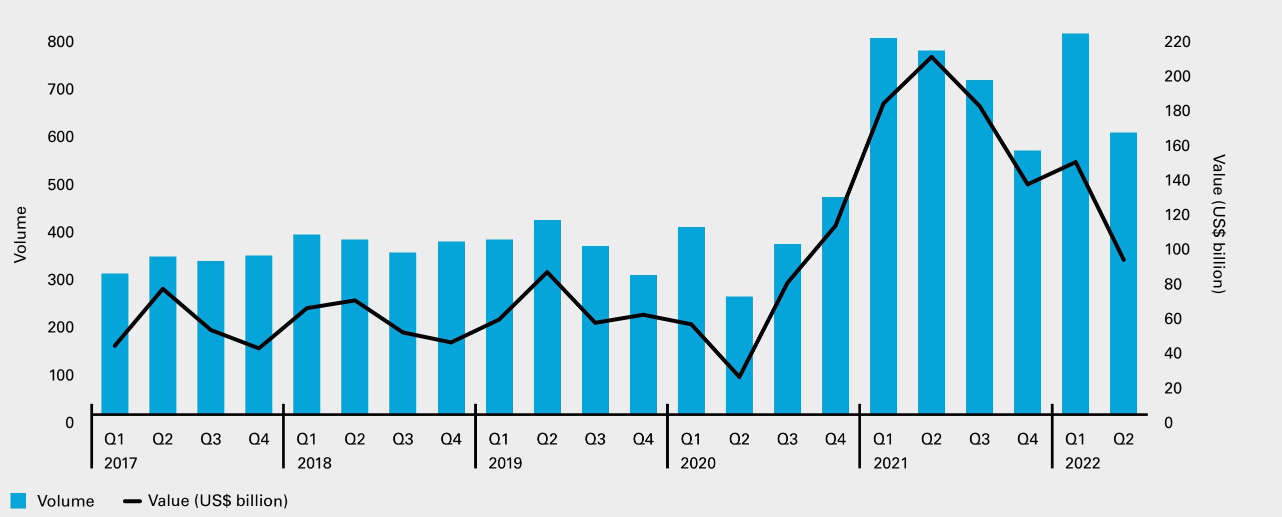
Yet, while an economic downturn is widely anticipated across the market, PE firms are well placed to take advantage of the investment opportunities these conditions present.

Tech deals dominate activity

The TMT sector saw the greatest level of buyout activity in the first six months of this year, by both value and volume. The number of transactions increased by 17 percent year-on-year to 727 deals—making it one of the few sectors that experienced an annual increase in the number of buyout transactions this year.

Transaction value stayed steady from H1 2021 to the same period this year, coming to a total of US$133.1 billion, just under the previous year's US$133.2 billion total.

US private equity buyouts 2017 – H1 2022



The largest buyout announced was Vista Equity Partners' US$16.6 billion purchase of Citrix Systems—a clear bet on a more permanent shift to hybrid working. Citrix's software—which enables employees to work securely from their devices remotely—saw demand soar amid the pandemic.

PE set to play pivotal role in energy transition

In response to investor pressure and consumer demand, PE investors are increasingly shifting their attention to clean energy targets. In January, US PE giant Blackstone conducted a landmark transaction in the renewable power space, investing US$3 billion in solar and wind developer Invenergy Renewables. Blackstone has already committed nearly US$13 billion in investments consistent with the broader energy transition since 2019.

The rest of the market is following suit. According to data from S&P Global Market Intelligence, US and Canadian venture capital and private equity firms invested a record US$6.8 billion in 2021 in energy efficiency, storage and management, along with new technologies to reduce carbon emissions.

727

The number of PE buyouts in the TMT sector in H1 2022—a 17% increase versus H1 2021

Buyout firms face tougher regulatory scrutiny

Although the private equity industry looks well positioned to take advantage of a more challenging economic climate, PE players are also bracing for higher levels of regulatory intervention.

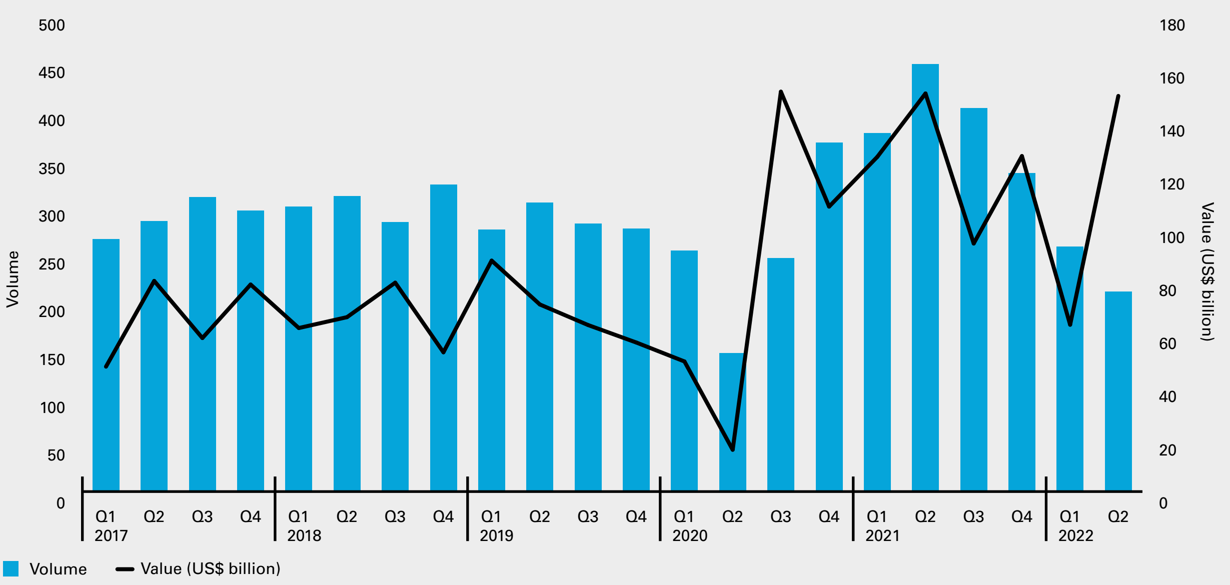
Biden administration officials have been vocal about how greater scrutiny should be applied to the industry. The DOJ's recently appointed head of antitrust, Jonathan Kanter, pledged to take a tougher stance on roll-up deals based on anti-competition concerns. Divestiture deals will also come under increased focus, if the sale is seen as making a company less competitive within its industry.

To gain a more accurate competitive picture of deals, the DOJ, along with the FTC, is in the process of increasing disclosure requirements on pre-merger notification forms, while conducting an overhaul of merger guidelines in order to clamp down on anti-competitive deals.

The SEC, meanwhile, has taken steps to increase its oversight of private financial markets, voting in favor of a string of proposed regulations in February. The proposed rules, which include banning certain fees that buyout firms charge and blocking preferential terms for certain investors, are said to be the biggest step that the SEC has taken to improve oversight in the market since the passing of the Dodd–Frank Act in 2010.

While these regulatory changes have yet to materially impact the PE industry, buyout firms will be keeping a close eye on developments. Regulatory compliance may become more burdensome but, with adequate preparation, should not deter sponsors from transacting.

US private equity exits 2017 – H1 2022



SPACs are overcoming expectations

After a series of rollercoaster years for the SPAC market, investors and sponsors are finding ways to improve deal integrity

By James Hu and Matthew Kautz

SPACs have never faced such a challenging environment, for a number of reasons. The overhang of the SEC's proposed regulations regarding misleading financial projections have had a significant ripple effect. It is now extremely difficult to find banks willing to engage after they pulled back from the market almost overnight in late March. This has delayed deals as accountants come to terms with what information is required to be disclosed, and legal counsel now takes longer too. The due diligence bar has been set that much higher before a de-SPAC deal can be announced, stalling activity.

That's the regulatory angle. Then there is the lack of risk appetite for these deals. There have been high levels of redemptions from retail investors once deal targets have been announced. Part of that is a function of the wider shift from high-growth risk assets with a distinct tech flavor, a favorite of SPACs, in favor of stable earners and commodities plays amid the economic slowdown and attendant bear market.

A number of high-profile SPAC deals have also fallen far short of expectations, which is what has prompted the SEC's greater scrutiny. This means sponsors need more PIPE capital, which has been similarly unforthcoming, from institutional investors to close their deals.

Bottoming out

However, the worst has possibly already passed for the SPAC market. Sponsors and banks have adopted a more cautious sentiment over the past three months since the SEC announced its proposal, but stakeholders are quickly adjusting.

One of the most exciting recent developments in the SPAC space is the deal innovation. A case in point, in July, FAST Acquisition Corp. II entered into an agreement to combine with Falcon's Beyond, an entertainment development company specializing in intellectual property creation and expansion, in a de-SPAC transaction with a pro forma enterprise value of US$1 billion. The deal is noteworthy for introducing a unique structure whereby shareholders who do not redeem their shares will receive 50 percent of their shares as convertible preferred equity with a sizable 8 percent dividend and US$11 conversion price and 50 percent common stock. What's more, 20 percent of the founder shares held by FAST II's sponsor were forfeited and contributed to a bonus pool allocated to non-redeeming shareholders and PIPE investors, disincentivising the deal's abandonment.

This is just one example of how investors and sponsors have an abundance of options to improve the integrity of deals and ensure that they cross the finish line. Once the stock market finds its bottom and when there is greater regulatory clarity from the SEC, SPAC IPOs and de-SPAC activity should be in line for a recovery. It's unlikely that the frenzy of Q1 2021 will be repeated, but there will be plenty of headroom for the US SPAC market's growth as the interest rate cycle nears its end.

Sector overview: TMT remains on top

Boosted by a few record-setting tech deals at the top end of the market, TMT continues to dominate US M&A value

By Michael Deyong and Gregory Pryor

Technology, media and telecoms (TMT) continued its reign as the dominant sector for US M&A in the first half of 2022, despite a year-on-year collapse in the value of media and telecoms deals. Technology remains at the core of America's innovation economy and it shows in the deal data. There were US$415.4 billion worth of tech transactions, up 5 percent on the first half of 2021. Media and telecoms acquisitions fell by 79 percent and 40 percent, respectively, to US$31.3 billion and US$9.8 billion. This is despite a much-discussed softening of technology stock prices in the public markets.

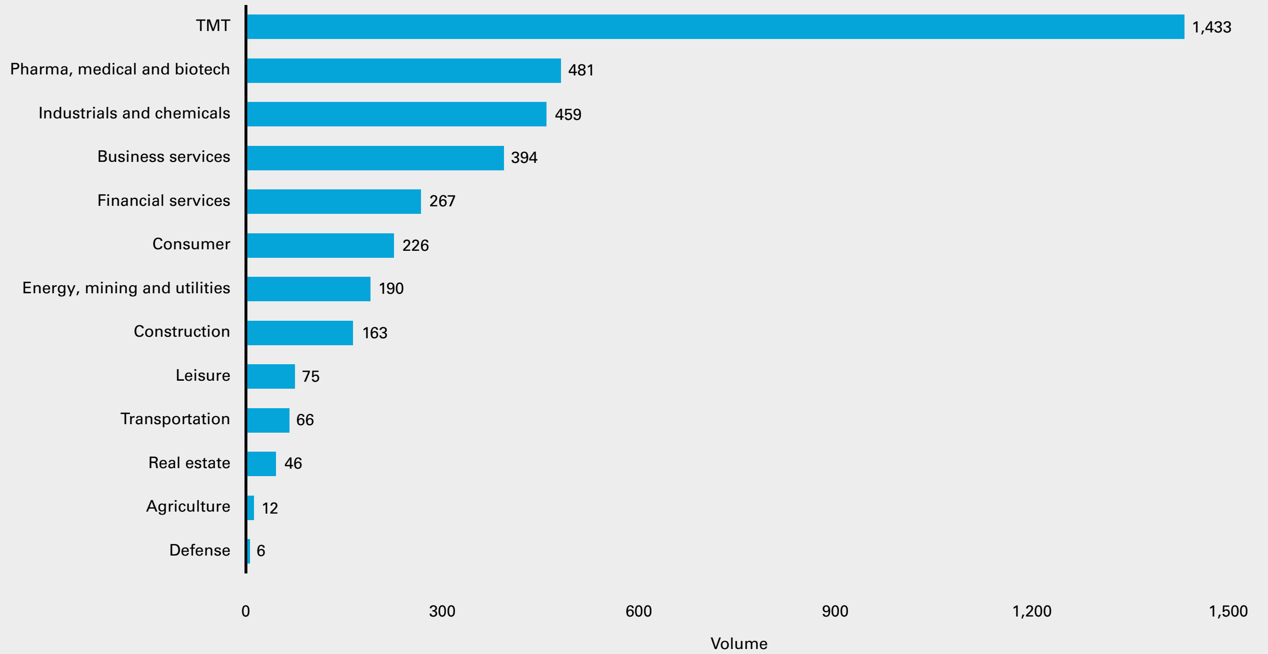
All of the top-three largest M&A transactions so far this year have been tech plays, led by Microsoft's US$75.1 billion bid for gaming company Activision Blizzard. Second to this was chipmaker Broadcom's US$71.6 billion offer for software business VMware, followed by Elon Musk's since-rescinded US$41.3 billion Twitter overture.

Even discounting these three outsized acquisitions would put the technology sector in the lead by a factor of more than two. What's more, technology delivered the most transactions by a vast margin. There were 1,299 tech M&A deals in H1 2022, down 4 percent year-on-year, nearly three times the second-highest volume sector, pharma, medical and biotech (PMB), which counted 481 deals, down 29 percent on the same period last year.

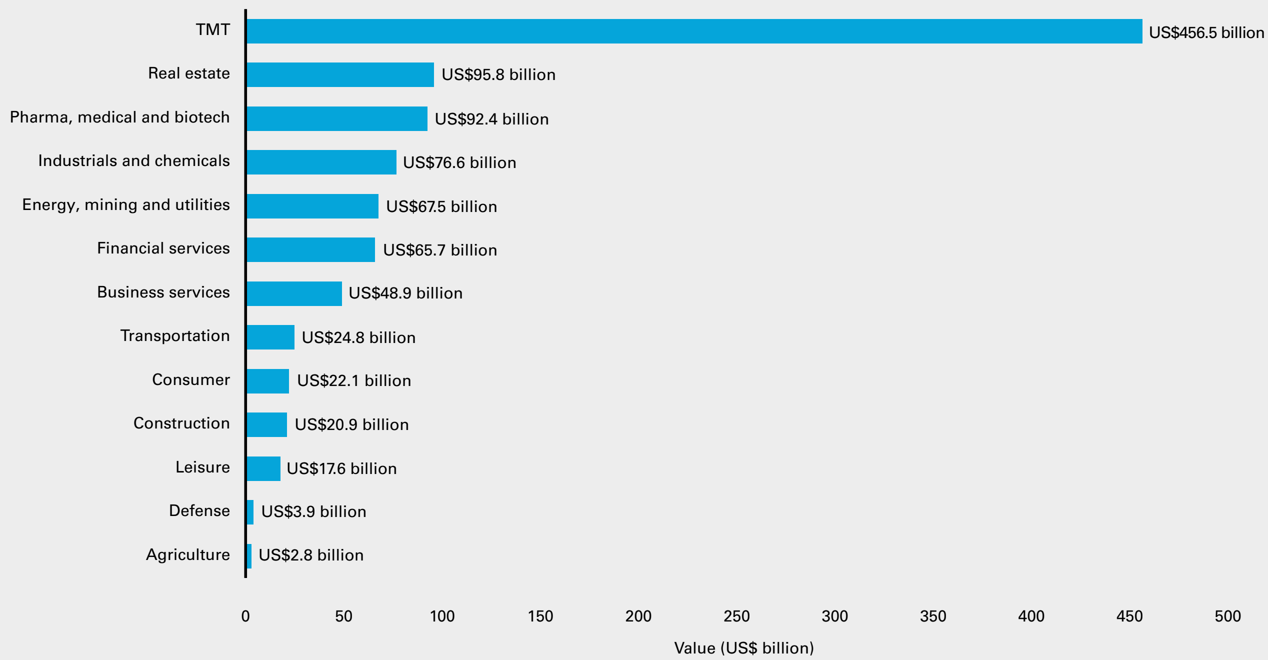
Real estate just beat PMB as measured in aggregate value, with a total of US$95.8 billion, a 109 percent annual gain. Nearly a third of this came from the US$27.9 billion all-stock acquisition of Duke Realty Corp. by Prologis, competing industrial real estate investment trusts specializing in warehouse logistics.

In many ways, the pandemic has left a lasting impression on M&A markets. Supply chains have been under immense pressure over the past two years, and best-in-class logistics services can help to relieve some of that burden by improving efficiencies and costs. In the case of PMB, which recorded US$92.4 billion, down 51 percent, Pfizer claimed the largest deal with its US$11.6 billion purchase of Biohaven Pharmaceutical. The pharma giant aims to commercialize the drug Rimegepant, sold under the Nurtec brand for the treatment of episodic migraines. Pharma giants are flush with cash since the pandemic, and are looking to deploy capital to shore up their drug pipelines.

US M&A sectors by volume H1 2022



US M&A sectors by value H1 2022



Oil & gas dealmaking continues to ride high in H1

A desire to consolidate and take advantage of relatively buoyant commodity prices is driving deals

By Morgan Hollins and Mingda Zhao

Dealmaking within the US O&G sector remained largely in line with H1 2021's strong activity, despite the ongoing challenges facing the industry. A total of 85 deals valued at US$44.2 billion were announced in the sector in H1—down 3 percent in value year-on-year, even as the number of deals ticked up by 9 percent.

This stable deal activity is in contrast to overall M&A activity in the US, which saw drops of 21 percent and 29 percent in terms of volume and value, respectively, over the same period.

Consolidation on the rise

Consolidation was a major feature of the US oil & gas market in H1, as smaller companies found it harder to survive amid challenging market conditions. Two of the five largest deals of the year: Centennial's US$3.9 billion acquisition of Colgate Energy, and Oasis Petroleum's US$2.8 billion purchase of Whiting Petroleum, highlight the need to gain scale in a historically fragmented market.

The Centennial/Colgate merger will create the largest pure-play exploration and production Delaware Basin operator in West Texas and Southeast New Mexico. Oasis's acquisition of Whiting, meanwhile, significantly expands its presence in the core acreage of the Williston Basin, which stretches across western North Dakota and eastern Montana.

The US domestic oil & gas market remains a fragmented market, and with volatility in energy commodity prices cooling down, further transactions are likely to take place in H2, with the potential for larger deals.

Take-private deals secure value

The largest deal to take place in the sector was the Hamm family's proposed purchase of its remaining stake in Continental Resources, in a bid to take the US shale producer private. The move comes as US shale companies are reporting record cash flows after the war in Ukraine pushed up global oil prices. Similar deals could follow if companies do not feel that the public markets accurately reflect their current value.

Greater stability brings confidence

While not completely immune to current economic volatility, energy businesses tend to react differently to downturns compared to the general M&A market. Demand for energy is usually resilient during downturns, and the steady returns energy assets offer are especially attractive to investors when growth is sluggish.

While there was some volatility in commodity prices toward the start of the year surrounding the impact of geopolitical conflict, relatively stable commodity prices are bringing a greater sense of predictability to deal pricing. This ability to price deals, despite the uncertain geopolitical and economic backdrop, could set the scene for strong levels of M&A activity over the remaining half of the year.

US $44.2 billion

The value of 85 deals targeting the US oil & gas sector in H1 2022

9%

Percentage increase in volume compared to H1 2021

Top oil & gas deals H1 2022

1

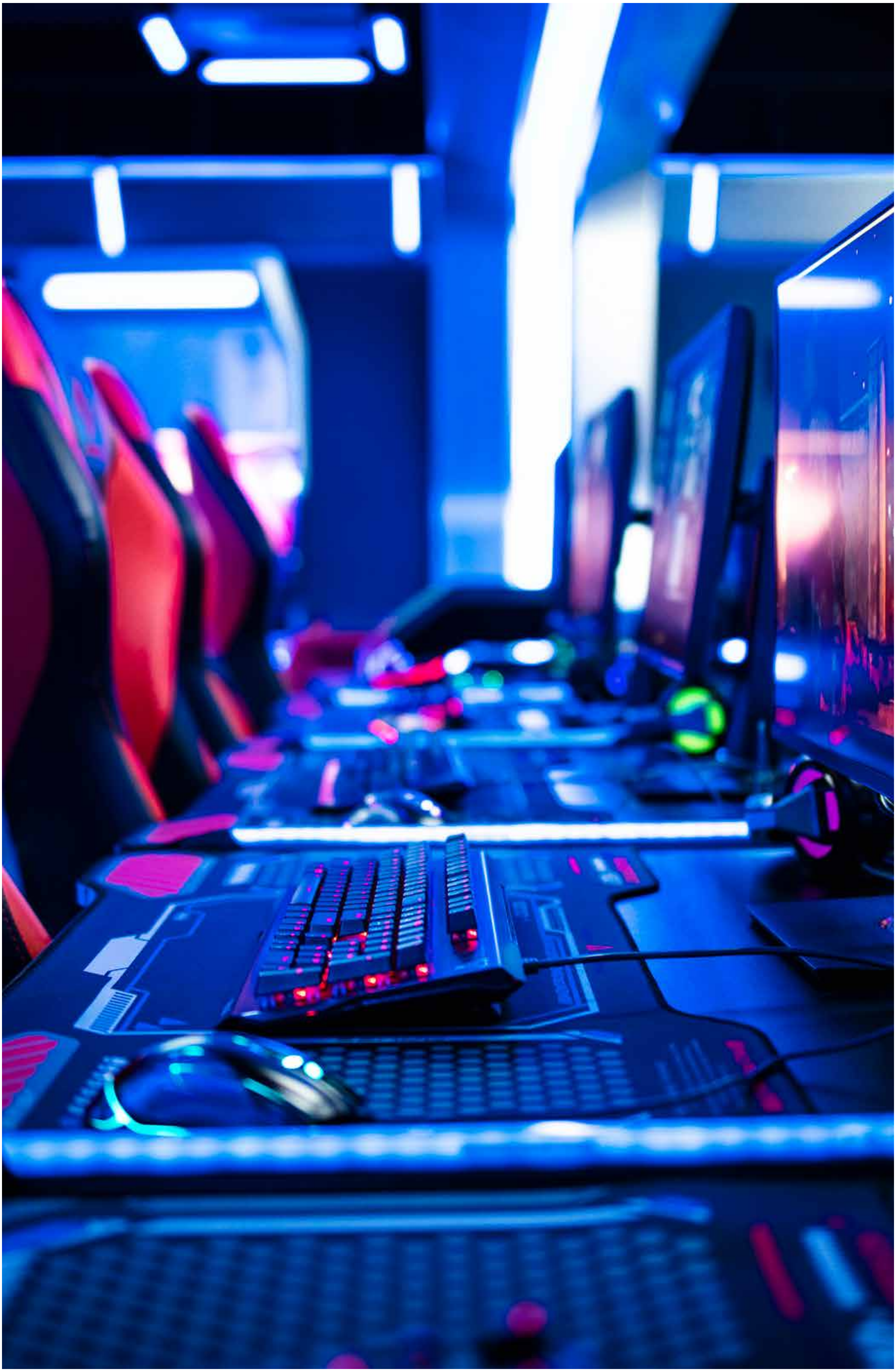
Harold Hamm and his family offered to acquire an 18.71 percent stake in Continental Resources, the company he founded, for **US$4.8 billion** in order to take the company private

2

Centennial Resource acquired Colgate Energy for **US$3.9 billion**

3

Lucid Energy Group received a **US$3.6 billion** offer from Targa Resources



Technology value stays strong, despite public market woes

Dealmaking in the US technology sector flourished in H1, despite a much-publicized fall in stock market valuations

By Arlene Arin Hahn, Tali Sealman and Linda Sim

The technology sector continued to be the driving force behind US dealmaking in H1 2022. A total of 1,299 deals valued at US$415.4 billion took place in the US tech sector in H1 2022, maintaining tech's status as the most active sector in terms of both value and volume.

Against a background of overall declining deal activity in the US this year, tech M&A maintained healthy deal activity—tech deal volume dropped slightly by 4 percent, while the aggregate deal value rose by 5 percent.

Thanks in large part to a few outsized deals, activity was especially robust at the top end of the market. Deals worth US$5 billion or more totaled US$282.8 billion in H1, a 58 percent increase year-on-year. In contrast, deals worth less than US$5 billion came to US$132.6 billion in aggregate, a 39 percent decrease from the same period the year before.

US $415.4 billion

The value of 1,299 deals targeting the US tech sector in H1 2022

5%

Percentage increase in deal value compared to H1 2021

Megadeals reach new highs

The highest-valued deal in the technology sector so far this year was Microsoft's US$75.1 billion acquisition of US-based videogame developer Activision Blizzard, announced in January. If approved by regulators, the deal would not only be the largest transaction announced so far this year globally across all sectors, but the biggest technology deal on record in Mergermarket history (since 2006).

Although the Microsoft/Activision transaction is a record-breaker, it is only slightly larger than the second-biggest deal of the year so far, Broadcom's US$71.6 billion purchase of cloud computing firm VMware.

These two deals together accounted for 36 percent of total deal value within the sector—a sign of how outsized they are. Despite an economic downturn, the top end of the market could remain active due to large tech players having strong strategic rationale for continued dealmaking.

Mind the valuation gap

After years of buoyant stock market prices, the technology industry has seen public market valuations take a tumble this year. The S&P North American Technology Sector Index is trading at around 25 percent below the start of the year, causing valuations to decrease. These challenging conditions make it more difficult for dealmakers to both value companies and carry out deals.

As a result, there is also a hesitancy among companies to pull the trigger on deals. Well-planned merger agreements, using earn-outs and other types of deferred compensation, however, can be utilized to ease worries about deals, especially if there is a strong rationale for the transaction.

With the continued growth of online shopping and services, and adoption of digital transformation, activity in the technology sector will undoubtedly remain high relative to other sectors, despite the drop in public market valuations.

Top technology deals H1 2022

1. Microsoft's **US$75.1 billion** bid for Activision Blizzard
2. Broadcom's bid for VMware for **US$71.6 billion**
3. Elon Musk's **US$41.3 billion*** bid for Twitter

**Elon Musk is seeking to walk away from the Twitter deal, and Twitter has filed suit in the Delaware Court of Chancery to enforce the merger agreement.*

Big pharma firms return to the deal table in H1

Cash-rich pharma firms look set for a buying spree, as favorable biotech valuations and patent expirations incentivize dealmaking

By Arlene Arin Hahn, James Hu and Andres Liivak

Dealmaking activity in the US healthcare sector was robust in H1 2022 in the face of various macroeconomic headwinds. There were US$92.4 billion worth of deals announced in H1 2022. This was a 51 percent decrease from a record 2021, but it is still firmly ahead of pre-pandemic levels of activity.

A total of 481 announced deals, meanwhile, represents a 29 percent drop in volume year-on-year, although it is still a 37 percent increase compared to H1 2020.

Cash-rich big pharma snaps up biotech firms

A resurgence of activity among big pharma firms snapping up biotech assets was a major feature of H1 dealmaking. This trend resulted in the highest-valued deal of the year so far: Pfizer's US$11.6 billion bid for biotech firm Biohaven. The deal, which is Pfizer's highest-valued deal in more than five years, comes at a time when cash-rich big pharma firms are looking to take advantage of softening biotech valuations.

Many biotechs are struggling with falling valuations, as investors who had acquired shares during the pandemic amid soaring valuations sold off earlier in the year. Some investors believed that biotech stocks—especially those at early stages of the clinical trial and approval process—were overvalued during the pandemic and were keen to cash out once the initial hype had settled.

This situation vastly contrasts to big pharma firms, many of which are sitting on large war chests of capital amassed during the pandemic and are keen to put this to work. This large amount of cash, combined with falling valuations in the biotech sector, is likely to continue to generate deals over the coming year.

Patent cliff looms on the horizon

Big pharma firms may also be motivated to undertake acquisitions as they survey potential patent cliffs (or expiration of patent rights), with the industry's top drug companies expected to lose more than US$200 billion in revenue by 2030 due to loss of exclusivity. According to consulting firm ZS Associates, the top-ten pharmaceutical manufacturers have more than 46 percent of their revenues at risk between 2022 and 2030. Bristol Myers Squibb, Pfizer and Merck will be among the most exposed over the next decade.

This challenge may catalyze M&A in the industry, as large firms look to recoup lost revenue streams.

51%

Percentage decrease in the value of deals targeting the US healthcare sector in H1 2022 compared to H1 2021

US $92.4 billion

The value of 481 deals targeting the US healthcare sector in H1 2022

Top healthcare deals H1 2022

1. Pfizer acquired Biohaven Pharmaceuticals for **US$11.6 billion**
2. UnitedHealth and Optum acquired LHC for **US$6.1 billion**
3. BMS bought Turning Point Therapeutics for **US$4.6 billion**

Retail M&A is out of favor for now, but quality consumer brands stand strong

Deal activity in consumer and retail decline as inflation worries hit confidence

By Shiva Sandill

Consumer and retail sector M&A took a backseat in 2022. A total of 226 deals were announced in the US year-to-date, a 34 percent drop compared to the first half of last year. Aggregate deal value dropped by an even steeper rate to US$22.1 billion, a 60 percent shortfall on H1 2021.

The more challenging deal conditions in the consumer and retail sector this year can be seen not only in the drop in the value and volume of deals but in the abandoned M&A process for department store chain Kohl's. The retail chain had been in sale talks with Franchise Group but pulled the deal in late June, after cutting its outlook for the second quarter.

The easing of pandemic constraints in Q1 helped consumer businesses, but this welcome reprieve was shortly offset by a worsening macroeconomic outlook. Spiraling inflation—the consumer price index reached a post-1970s high of 9.1 percent in July—has seriously dented consumer and investor confidence.

Rising interest rates will increase unemployment—this means that Americans are tightening their belts and reining in discretionary spending where possible. In June, the University of Michigan Consumer Sentiment Index fell to an all-time low, although the index edged up slightly in the July survey.

Not all doom and gloom

There are still pockets of opportunity, however, that are benefiting from strong secular trends. ESG is a major motivator for deals, as is health and wellness, as consumers take better care of themselves. In the largest deal of the year so far, Nasdaq-listed Mondelēz International, the owner of Oreo and other iconic snack brands, picked up Clif Bar & Company for US$2.9 billion. Clif specializes in energy bars that use organic ingredients, aimed at fitness enthusiasts who are mindful of what they put in their bodies.

Consumer demand for ESG presents an excellent opportunity for investment and acquisitions into sustainable brands. Companies that are socially conscious and promote diversity and inclusion (D&I) will also receive considerable interest from potential buyers.

For now, the macro environment may not be conducive to major retail acquisitions, particularly those involving listed groups exposed to recent market volatility. But private consumer companies with star products are still very much on the menu, as strategics and sponsors look to reposition their portfolios for future growth.

34%

Percentage decrease in the volume of deals targeting the US consumer sector in H1 2022 compared to H1 2021

US $22.1 billion

The value of 226 deals targeting the US consumer sector in H1 2022

Top consumer deals 2022

1. Mondelēz is buying Clif Bar & Company for **US$2.9 billion**
2. BlackRock acquired a 55 percent stake in Fanatics for **US$1.5 billion**
3. PANTHERx was acquired by a consortium comprised of General Atlantic, Nautic Partners and The Vistria Group for **US$1.5 billion**

Real estate M&A defies downturn expectations in H1

Red-hot demand for warehouse space drove dealmaking in the sector in H1

By Elena Baca, Eugene Leone and David Pezza

US real estate M&A continued on from a strong 2021, more than doubling in value from US$45.8 billion in H1 2021 to US$95.8 billion in H1 2022, while deal volume rose 59 percent to 46 over the same period.

Significantly, real estate was among the only sectors to post a year-on-year increase in activity within the US. The sizable increase in deal value was in large part due to the largest deal of the year so far in the sector, Duke Realty's US$27.9 billion acquisition by US warehouse landlord Prologis, pending approval by shareholders and regulators. Although this transaction was an outsized one compared to the rest of the market, the increase in deal volume is also a promising sign for deal activity across the whole sector.

Competition heats up in industrial real estate

The Prologis/Duke Realty deal was driven by the soaring demand for warehouse space, thanks to the continued boom in e-commerce and rapid delivery services since the start of the COVID-19 pandemic.

E-commerce players have themselves been buying up land for development across the US, as they race to meet rapidly rising demand. Amazon, for example, doubled its owned real estate portfolio to 16.7 million square feet across North America in 2021, up from 8.5 million at the end of 2020, according to an annual financial report. Last August, the company spent US$85 million on a 133-acre site in Sunrise, Florida, where it plans to build a fulfillment center.

Multifamily assets attract attention

With interest rates on the rise, stock prices have been under some pressure. Yet the underlying core value of real estate assets remains strong, as the sector is seen as recession-resilient, offering a long-term stable investment option.

This has been a particular trend seen in multifamily residential rental properties. Expectations that rents will keep rising are curbing any investor worries about rising inflation, with demand for rental housing set to remain strong. With these factors in mind, M&A in residential REITs could increase in the rest of this year.

US $95.8 billion

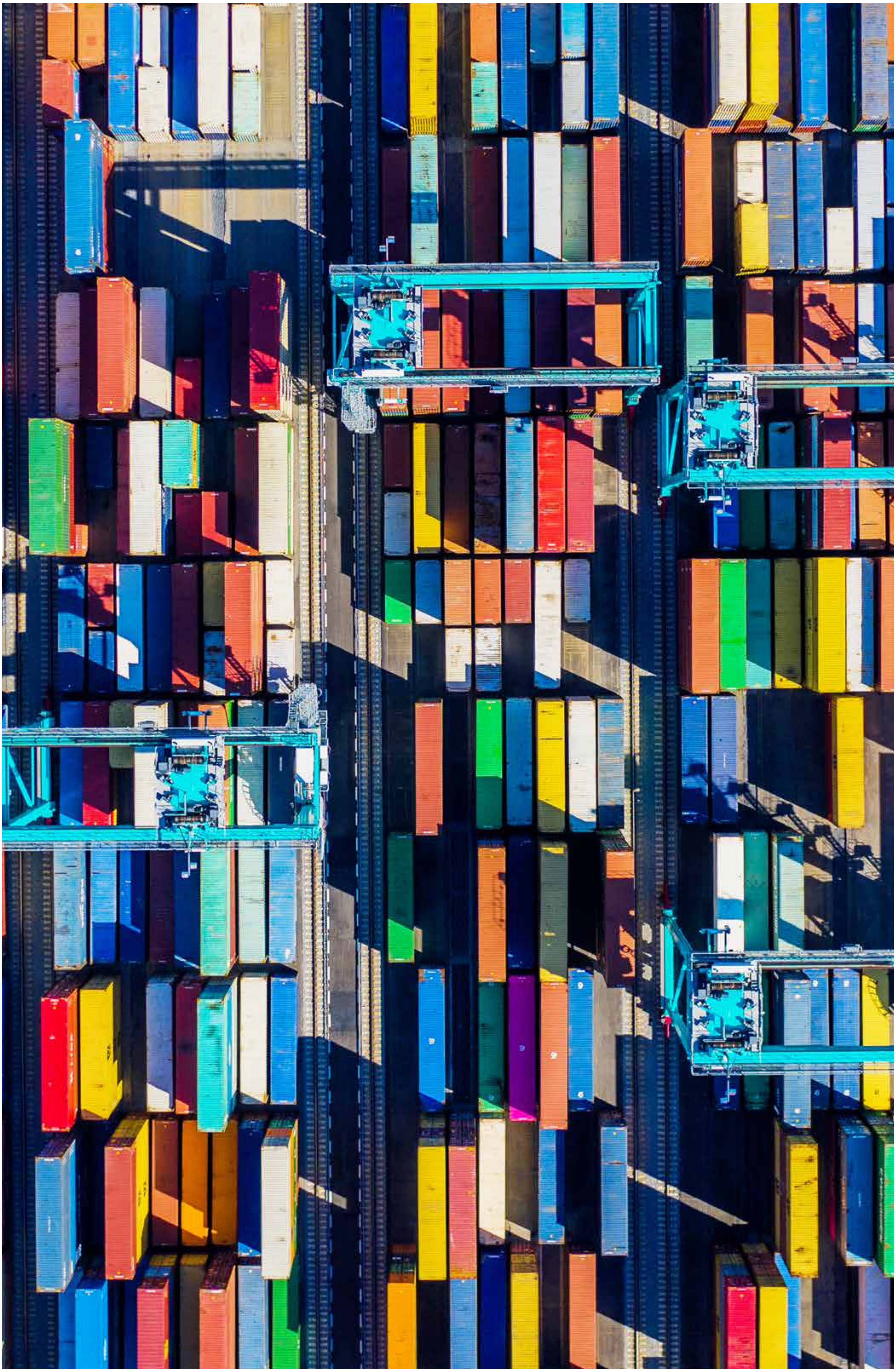
The value of 46 transactions in the US real estate sector in H1 2022

59%

Percentage increase in deal volume compared to H1 2021

Top real estate deals H1 2022

1. Prologis's **US$27.9 billion** bid for Duke Realty
2. American Campus Communities' **US$13.1 billion** acquisition by Blackstone
3. Healthcare Realty Trust's acquisition of Healthcare Trust of America for **US$11.2 billion**



CFIUS continues its watchful eye on foreign investment

Under the Biden administration, CFIUS continues its rigorous assessment of security concerns across a wider range of sectors

By Farhad Jalinous

The Committee on Foreign Investment in the United States (CFIUS), the interagency committee authorized to review certain transactions involving foreign investment into the US, continued to ramp up its outreach in 2021. Under the Biden administration, the committee remains steadfast in its comprehensive approach to deal reviews, with particular focus on a wide range of areas of interest, such as global supply chains, and an increased engagement with international allies.

Current state of play

In its Annual Report to Congress for calendar year 2021, CFIUS reported a nearly 40 percent increase in overall CFIUS filings in 2021 from 2020. Notwithstanding this substantial increase in volume, the metrics indicate that CFIUS has mostly maintained, and in some cases slightly improved, its efficiency in dealing with filings. Moreover, there were not significant increases in the percentage of transactions requiring mitigation or abandoned based on CFIUS concerns, though some cases requiring mitigation took longer to resolve. CFIUS also identified more non-notified transactions compared to the prior year, but ultimately requested fewer total filings. Overall, while parties are notifying substantially more transactions, CFIUS continues to approve the vast majority of cases without mitigation.

A broadened view on security

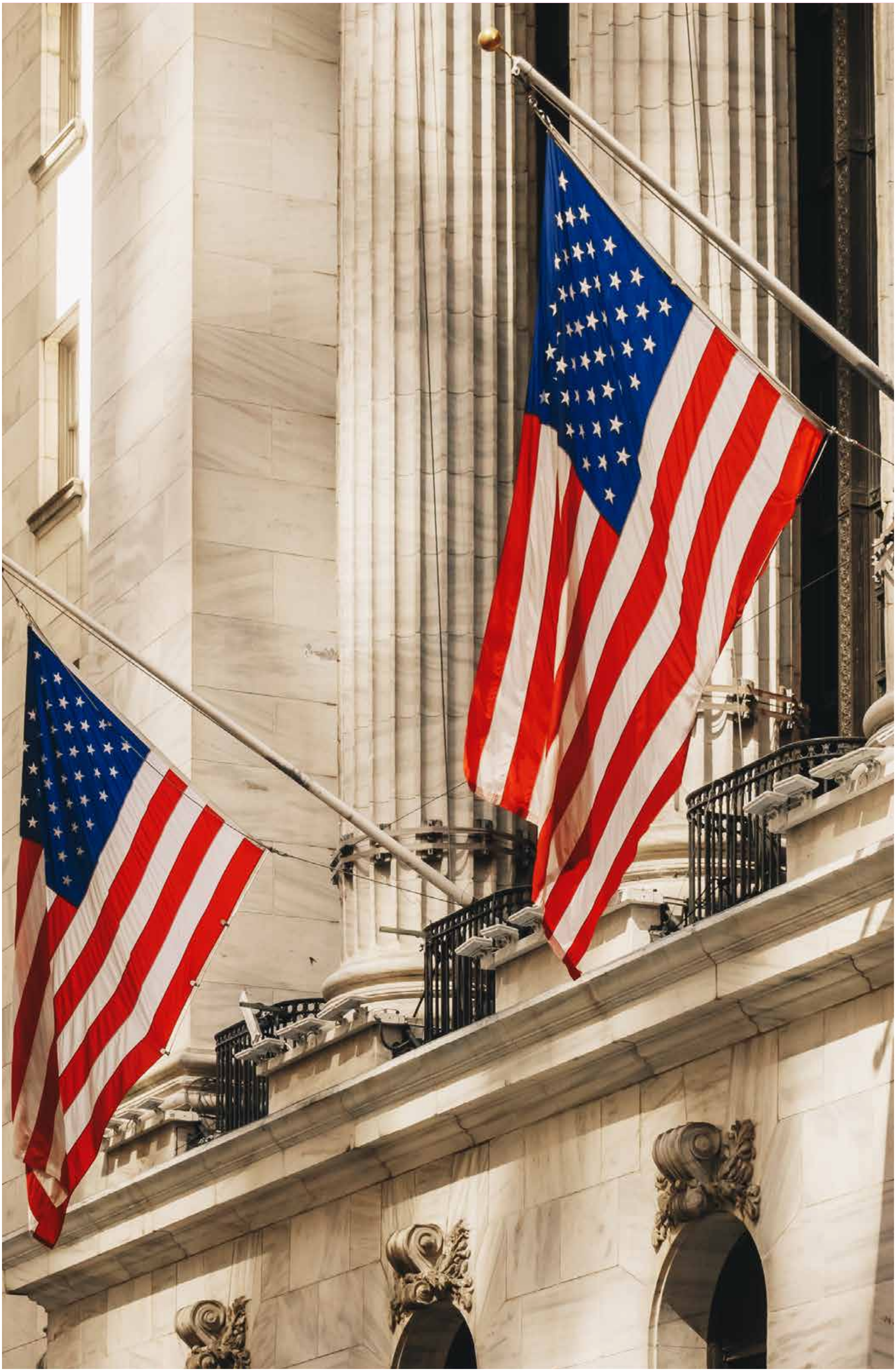
Under the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), CFIUS continues to broaden its involvement in certain sectors on the grounds of national security. One such example is real estate. FIRRMA's implementing regulations include separate regulations for investment and real estate transactions, and a single transaction cannot fall under both sets of regulations. While fewer than 2 percent of the CFIUS filings made in 2021 were pursuant to the real estate regulations, those regulations are useful for investment transactions because they provide parameters for assessing whether a target's US locations could raise national security concerns based on their proximity to sensitive US government facilities. This assessment is particularly important when a transaction involves investors from higher-threat countries.

Outbound investment control?

There remains some discussion surrounding the extent to which CFIUS should control outbound investments from the US, with interest in this area growing over the past six months. This has been driven by interest in having more control over outbound technology transfers and investments, beyond what is already in place through export control regulations.

In March of this year, US Secretary of Commerce Gina Raimondo expressed support for a screening regime to review outbound investments. This follows on from similar moves by the White House earlier this year, signaling that an outbound investment screening mechanism could be a possibility in the future.

> **A continuing trend under the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) is the increase in formal internal processes and procedures used to review investments.**



Antitrust enforcement set to ramp up in H2

New appointments in both the FTC and DOJ signal greater enforcement action on the horizon—with buyout firms a particular target

By Rebecca Farrington

In January, the Federal Trade Commission (FTC) and the Department of Justice (DOJ) announced a joint public inquiry to update the agencies' merger guidelines, which set out the framework by which the agencies assess the potential competitive effect of a merger. In their request for public comment, the agencies indicated particular interest in topics not previously covered by the guidelines, including threats to nascent competitors, the unique characteristics of digital markets, and effects on labor markets.

Both agencies' current leadership question the current consumer welfare standard, which they believe did not go far enough to address competition issues in the US market.

The analysis of the merger guidelines is part of the Biden administration's more aggressive attitude toward antitrust, as exemplified through actions and words of recent leadership appointments. Jonathan Kanter was appointed head of the DOJ's antitrust division last November, and takes a more expansive view on antitrust enforcement than many of his predecessors. Both Kanter and FTC Chair Lina Khan, have been vocal critics of Big Tech, in particular.

Clampdown on PE

Ahead of the update to the merger guidelines, the FTC and DOJ have also publicly stated on multiple occasions their intent to scrutinize private equity more closely. One area that has already received attention has been platform, or "roll-up" transactions, which involve buying and consolidating multiple smaller firms in the same industry. Also called buy-and-build, this strategy has grown in popularity in recent years.

In June, the FTC announced a consent order against JAB Consumer Partners requiring the PE firm to divest 16 veterinary clinics as part of its acquisition of SAGE Veterinary Partners. JAB had previously bought Compassion-First Pet Hospital and National Veterinary Associates both in 2019 and subsequently acquired a string of more than ten smaller veterinary businesses around the US.

Breaking the deadlock

After a long delay, in May the Senate confirmed Alvaro Bedoya as an FTC commissioner, filling a role that had been left unfilled since October 2021. Until the confirmation, the commission had been stuck in a deadlock of two Democratic and two Republican commissioners. Privacy expert Bedoya's appointment will mean that the FTC will be more empowered to pursue the progressive enforcement and policy agenda favored by Chair Khan.

"One area that has already received attention has been platform, or "roll-up" transactions, which involve buying and consolidating multiple smaller firms in the same industry.


RVA 1Q LOSS/SHR 25C
CRM
CVS
128.14
41.87
GOLD
GOOG

SEC: The watchdog bares its teeth

The SEC has followed through on promises to increase enforcement

By Tami Stark

The Securities and Exchange Commission (SEC) has followed through on its much publicized intention of more aggressive enforcement. For instance, in June, the regulator brought an accounting fraud action that included a clawback of a CEO's compensation, notwithstanding that the CEO did not have a role in the stated misconduct. Through this action, the SEC has made it clear that when there is a restatement of a public company's financial statements, it will exercise its powers under the Sarbanes Oxley Act to claw back compensation, even if a CEO or CFO is not directly charged with misconduct. Such compensation includes equity-based incentives and the profits from sales of a company's stock during the restatement period. This is known as a SOX 304 clawback and this action signals a significant broadening of this remedy, as the SEC is not requiring misconduct by senior management.

Admissions have also become a focal point. In December, rather than settle on a "neither admit nor deny" basis, a broker-dealer admitted to certain record-keeping violations in an SEC settlement. In this matter, certain employees communicated about securities business over their personal devices using, for instance, text messages and WhatsApp without maintaining and preserving those communications. An admission is significant because it can sometimes be used by private securities litigation attorneys to get past the motion to dismiss stage and into discovery. Notably, there is no private right of action for the type of violation this broker-dealer admitted to. So, while the entity admitted to the failing, it could settle without a significant risk of private litigation. It remains to be seen, however, whether a company will admit to a regulatory breach that also leaves it exposed to private action.

SPAC watch

Regarding the impact of enforcement on M&A activity specifically, SPAC markets have been especially sensitive to a more hawkish SEC. The heightened focus of the Enforcement Division on de-SPAC transactions has contributed to these deals slowing, as market participants in de-SPAC transactions digest their enforcement risk exposure and prepare for new SEC rules.

The rise of ESG disclosure scrutiny

One of the biggest areas of ongoing development, meanwhile, is in ESG enforcement actions. In April, the Enforcement Division's Climate and ESG Task Force brought its first enforcement action against a mining company for making false and misleading statements in violation of the antifraud and reporting provisions of the US securities laws. The misleading statements were delivered at an investor presentation and made in the company's sustainability reports and SEC filings. They related to the safety and risk management of a dam prior to its fatal collapse.

The following month, the Enforcement Division's Climate and ESG Task Force brought a second action against an investment advisor for misstatements and omissions relating to ESG considerations when making investment choices for a number of mutual funds under its management. The investment advisor implied in various statements that all investments in the funds had undergone an ESG quality review, despite this being untrue. These enforcement actions underscore that the SEC is not waiting for the new ESG rules in order to start scrutinizing ESG related disclosures by public issuers and regulated entities.

> **"These enforcement actions underscore that the SEC is not waiting for the new ESG rules in order to start scrutinizing ESG-related disclosures by public issuers and regulated entities.**

Walking the tightrope of Russia sanctions

Buying an asset with operations in Russia remains permissible under sanctions laws, but any such process must be carefully considered

By Nicole Erb and Genevra Forwood

The conflict in Ukraine and subsequent sanctions have had a chilling effect on M&A involving Russian entities, as these assets are now squarely off-limits for US buyers.

The Office of Foreign Assets Control (OFAC), the financial intelligence and enforcement agency of the US Treasury Department, in June issued guidance that provided clarity on what types of deals may be permissible, although many remain highly complex from a compliance standpoint.

Broadly speaking, acquiring an equity interest in a company outside of Russia that may have some Russian operations can proceed under US sanctions law, under certain circumstances. But the devil is always in the details.

A fact-specific analysis is necessary to understand the purpose of the investment, the extent of the target company's investments in Russia, and what the revenues from those Russian investments might be for the target company, before a US investor can get comfortable with an acquisition.

There are many nuances around the edges. OFAC has not determined specific thresholds, rather the language in the regulator's guidance centers on "predominance." Any non-Russian target that derives a predominant portion of its revenues from its Russian investments could therefore elicit some form of sanctions risk. A company that receives upwards of 51 percent of revenues from Russia would now clearly be off-limits. However, the predominance test could be interpreted more conservatively to apply to companies that receive the largest share of their revenue from Russia, which may still be a minority share.

Even for permissible transactions, it should be kept in mind that banks and other financial institutions commonly engage in over-compliance. With that in mind, investors are strongly advised to pre-clear even sanctions-compliant deals through the transaction chain, not just with the originator or beneficiary banks but with the intermediaries too. Otherwise, at any point in the deal, process banks may delay or block a deal based on their own internal policies, leading to unnecessary and avoidable challenges to the transaction's completion.

Divestments create their own headaches

A number of major multinational companies have begun pulling out of Russia, and this race to divest raises challenges too. In any divestment transaction, there's an investing party on the other side. That typically means exiting to a Russian company or the existing management, or in some cases to a business in a different country that has its own set of restrictions. US, UK or European companies, for example, must navigate not only the sanctions relating to blocked persons but also adhere to any export controls when transferring assets, particularly technology that authorities may consider strategically sensitive. Such items can include everyday office equipment, items used in manufacturing, and so-called "luxury goods."

There are also the financial institutions involved in the deal to consider. Extensive sanctions have been placed on Russian banks and acquirers, and sellers need to be extremely careful about which parties are mandated to administer a given deal.

There is a lot to think about and, as ever with sanctions, the situation is evolving. Sanctioned individuals are constantly being added to the blacklist by one authority or another, in some cases inconsistently. Investors must proceed with caution and the utmost diligence by carrying out a complex analysis of sanctions risks before attempting to execute any deal that may have some exposure to Russia.

> **Investors are strongly advised to pre-clear even sanctions-compliant deals through the transaction chain, not just with the originator or beneficiary banks but with the intermediaries too.**

Notable decisions from Delaware courts

In the first half of 2022, Delaware courts issued several important decisions affecting M&A dealmaking, including the following

By Thomas Christopher and James Hu

***MultiPlan:* Chancery court assesses fiduciary duties in the context of de-SPAC transactions**

The Delaware Court of Chancery declined to dismiss, at the pleading stage, breach of fiduciary duty claims made against a SPAC's directors, officers, controlling stockholder and its financial adviser in connection with the SPAC's 2020 acquisition (by way of merger) of MultiPlan, Inc., a healthcare industry-focused data analytics and cost management solutions provider. While noting that "Delaware courts have not previously had an opportunity to consider the application of our law in the SPAC context," the *MultiPlan* Court applied "well-worn fiduciary principles" to the plaintiffs' claims.

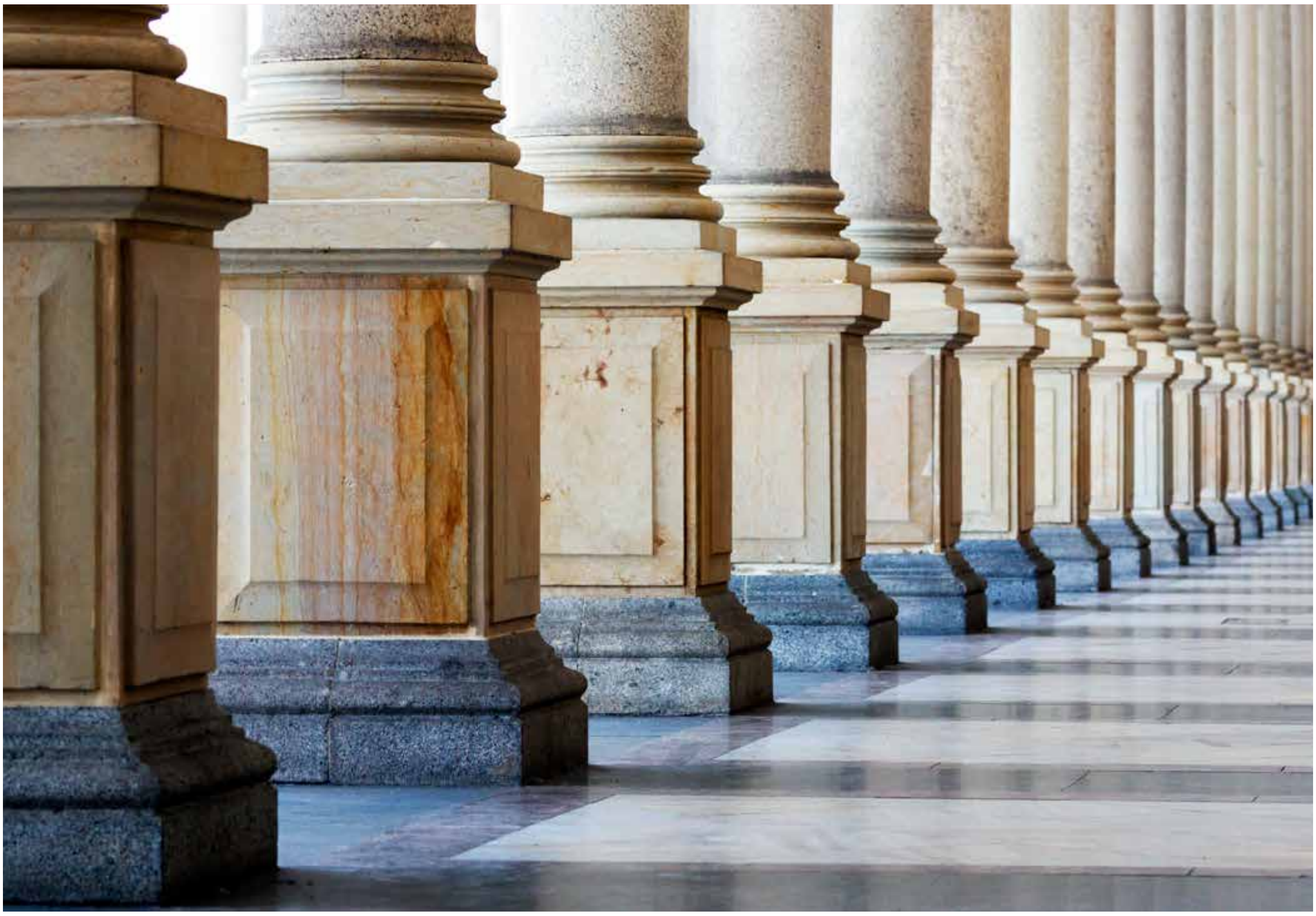
Plaintiffs alleged that the SPAC's fiduciaries—motivated by financial incentives not shared with public stockholders—impaired the public stockholders' ability to make a knowing and informed decision whether to have the SPAC redeem their shares for essentially their original purchase price in connection with the acquisition. According to the complaint, the defendants breached their duties of loyalty and disclosure to the plaintiffs by intentionally failing to disclose in the proxy statement that MultiPlan's largest customer (which represented more than approximately 35 percent of its revenues) was building an in-house platform to compete with MultiPlan and would likely withdraw its business from MultiPlan by the end of 2022. The defendants moved to dismiss plaintiffs' claims on several grounds—primarily, that plaintiffs alleged derivative claims but failed to plead demand futility and that the deferential business judgment rule applied.

The Court rejected defendants' arguments, finding that plaintiffs pleaded direct (not derivative) claims based on the purported impairment of their redemption rights. In addition, the Court held that Delaware's most onerous standard of review, entire fairness, applied due to inherent conflicts between the SPAC's fiduciaries—including its directors, officers and controlling stockholder—and public stockholders in the context of a value-decreasing transaction. The Court emphasized that a reasonably conceivable impairment of public stockholders' redemption rights—in the form of materially misleading disclosures—had been pleaded in this case, suggesting that if the proxy statement had contained complete and appropriate disclosures, the outcome would likely have been different. While potential conflicts were known to public stockholders who chose to invest in the SPAC, those stockholders were allegedly robbed of their right to make a fully informed decision about whether to redeem their shares. As a result, the fiduciary duty claims against the SPAC's directors, controlling stockholder and its CEO, as well as an aiding and abetting claim against the SPAC's financial adviser (which was controlled by the same party that controlled the SPAC), survived the motion to dismiss, while those against the SPAC's CFO were dismissed.

While *In re MultiPlan* represents a novel context for the Court to apply its fiduciary duty jurisprudence, its reasoning was based on, and applied, well-established legal principles familiar to M&A practitioners. Delaware courts have always been wary of potential conflicts, and de-SPAC transactions are no exception. The conflict identified by the Court was the divergence of interests between the SPAC's directors, officers and controlling stockholders, on the one hand, and the SPAC's other stockholders, on the other hand in certain stock price scenarios, and echoed the concerns of past Chancery Court decisions regarding divergent interests between common and preferred stockholders. Viewed in that light, this is not a particularly surprising outcome.

Key takeaways from the Chancery Court's *MultiPlan* decision include the following:

- Due to the inherent conflicts between a SPAC's directors, officers and controlling stockholder (i.e., its sponsor), a Delaware court considering fiduciary duty claims against these parties is likely to apply Delaware's entire fairness standard of review



- The redemption rights of SPAC stockholders represent a critical investment decision for them, and accordingly proxy statement disclosures relevant to that decision will be closely scrutinized to ensure they are accurate and complete and

- SPAC sponsors may wish to consider taking steps to reduce the divergent interests between SPAC directors and public stockholders, such as ensuring that the SPAC independent directors are compensated regardless of whether a business combination is completed

***Arwood v. AW Site Services*: Delaware's pro-sandbagging stance (apparently) reaffirmed**

In *Arwood v. AW Site Services*, the Delaware Chancery Court rejected defendant's "sandbagging defense" to plaintiff's claims for breach of representations and warranties in a purchase contract, declaring that, "Delaware is, or should be, a pro-sandbagging jurisdiction." The case arose in connection with an acquisition by AW Site Services (AWS) of waste disposal businesses founded and owned by John D. Arwood. Following the closing, AWS asserted fraud and indemnification claims under the purchase based on an alleged massive billing scheme that caused a substantial overstatement of the acquired businesses' revenue. The Court rejected AWS's fraud claims, as it determined that Arwood did not knowingly and intentionally devise a scheme to defraud AWS, and that AWS, as a sophisticated buyer that had conducted a thorough due diligence investigation of the acquired businesses, was unable to establish "justifiable reliance" on the relevant representations in the purchase agreement.

However, the Court did find in favor of AWS's breach of representation claims. The Court found that "[t]he specious customer billing scheme that AWS points to in support of its claims was real and it renders certain of the seller's representations in the [purchase agreement] false. That constitutes a breach of contract and triggers the breach remedies set forth in the [purchase agreement]." The Court rejected Arwood's "sandbagging" defense that AWS could not sue for breach of contract if it knew the representations were false or was recklessly indifferent to their truth, finding that "[t]he sandbagging defense is inconsistent with our profoundly contractarian predisposition." "Viewed through the lens of contract, not tort, the question is simple: Was the warranty in question breached? If it was, then the buyer may recover—regardless of whether she relied on the warranty or believed it to be true when made." The Chancery Court went on to say that even if Delaware was an anti-sandbagging state, it would not have precluded the plaintiff's contractual claims in this case because the defense requires that the plaintiff have actual knowledge of a representation's falsity and, in this case, AWS only had "reckless indifference" to the truth.

The decision appears to run counter to dicta in the Delaware Supreme Court's decision in *Eagle Force Holdings, LLC v. Campbell*, where the Court noted that it was an "interesting question" whether a party could assert a claim for breach of a representation and warranty that it knew at the time of signing to be false, as well as the statement by then-Chief Justice Strine in a dissenting opinion in that case expressing "doubt" about the viability of such a claim in those circumstances. To the extent there is continuing uncertainty on this issue, practitioners may be well served to seek to address the issue—one way or the other—in the purchase agreement. If they choose to remain silent on the issue, they should keep in mind this uncertainty, and apprise their clients accordingly.

Cox Communications Inc. v. T-Mobile US, Inc.: Delaware Supreme Court discusses enforceable preliminary agreements

In *Cox Communications, Inc. v. T-Mobile US, Inc.*, the Delaware Supreme Court overturned a Chancery Court decision that a settlement agreement between Cox Communications and T-Mobile provided that if Cox desired to enter the wireless mobile service market, it was required to do so with T-Mobile. In *Cox*, the Delaware Supreme Court applied its earlier decision in *SIGA v. PharmAthene* in which it recognized that parties can enter into two types of enforceable preliminary agreements. Type I agreements reflect a consensus "on all the points that require negotiation" and indicate the mutual desire to memorialize the agreement in a more formal document. In Type II agreements, the parties "agree on certain major terms, but leave other terms open for future negotiation." Type I agreements are fully binding, while Type II agreements do not commit the parties to their ultimate contractual objective but rather to the obligation to negotiate the open issues in good faith.

The *Cox* court held that the settlement agreement before it was unambiguously a "Type II preliminary agreement" that only required the parties to negotiate open issues in good faith. The Court remanded the case back to the Court of Chancery to determine whether the parties discharged their obligations to negotiate in good faith. Justices Valihura and Montgomery-Reeves concurred in part and dissented in part, finding that the relevant provision of the settlement agreement was ambiguous and thus concluding that the case should be remanded to the Chancery Court to consider extrinsic evidence regarding the parties' intentions concerning the provision.

Practitioners should keep in mind that letters of intent regarding potential M&A transactions might, under certain circumstances, be considered Type II agreements requiring good faith negotiations. Parties should therefore consider expressly detailing the extent of such obligations in their letters of intent.

ConMed: Chancery Court finds little difference among efforts standards

In *Menn v. ConMed Corporation*, the Chancery Court was asked to consider the obligations imposed on a party under a particular "efforts clause," i.e., a contractual clause intended to "define the level of effort that [a] party must deploy to attempt to achieve [an] outcome." The Court explained that such a clause replaces "the rule of strict liability for contractual non-performance that otherwise governs" with "obligations to take all reasonable steps to solve problems and consummate the "contractual promise." In *Menn,* the sellers alleged that, in connection with an earn-out provision, the buyer failed to comply with a contractual obligation to use "commercially best efforts" to develop and commercialize a surgical tool. While some transaction agreements expressly define the meaning of an efforts clause through stated benchmarks or otherwise, many, including the agreement before the *Menn* Court, do not. Consequently, the Court turned "to other inputs in search of guidance on the meaning of 'commercially best efforts.'"

The Court first observed that practitioners routinely use a variety of efforts clauses that they generally view as falling in the following hierarchy (in descending order): "best efforts," "reasonable best efforts," "reasonable efforts," "commercially reasonable efforts" and "good faith efforts." The Court noted that the efforts clause in question in the case—"commercially best efforts"—was not a common formulation.

The Court noted that while practitioners may recognize a hierarchy among the various standards, the courts "have struggled to discern daylight between them," and have "interpreted 'best efforts' obligations as on par with 'commercially reasonable efforts', [thus finding] even less daylight between 'best efforts' and 'commercially reasonable efforts.'"

The Court went on to state that "When assessing whether a party has breached an efforts clause in a transaction agreement, 'this court has looked to whether the party subject to the clause (i) had reasonable grounds to take the action it did and (ii) sought to address problems with its counterparty.'" "This standard applies with equal force to 'reasonable best efforts' and 'commercially reasonable efforts' language." In that context, this court has interpreted "best efforts" to require "a party to do essentially everything in its power to fulfill its obligation (for example, by expending significant amounts or management time to obtain consents)."

The Court cited cases in the merger context where a breach of a best efforts obligation was found due to a party failing to work with its counterpart to jointly solve problems, failing to keep the deal on track, or submitting false data to, and refusing to cooperate with, regulators. Other cases involved using a sales force that was too small to achieve the revenue target, expending energy and resources on stimulating an alternative to the deal, or making no effort to sell or market the product. Finding no similar actions in this instance, the Court ruled in favor of the buyer. Interestingly, the Court cited favorably to cases where, unlike here, parties had set forth a "yardstick"—a contractual definition by which the Court was to measure the particular level of effort. In situations where the level of effort is particularly important, parties should consider defining the desired standard as precisely as possible.

What's next for US M&A?

Five factors that will shape dealmaking over the coming 12 months

By Michael Deyong and Gregory Pryor

As predicted in our previous M&A report, 2022 has not lived up to the runaway performance of 2021. As activity—still at impressive levels considering everything that has been thrown at the deal market—takes a breather, we consider five fundamental trends that may play out over the coming months.

1

Rates and financing costs to increase

The increasing interest rate environment has, and will inevitably continue, to make deal financing more costly as spreads widen. Leveraged loans and high-yield bonds are at the riskier end of the curve, and PE firms rely heavily on this financing. It is likely that direct lenders will step in to pick up some of the slack left by more cautious capital markets. Either way, buyers dependent on acquisition financing will need to adjust for this accordingly—potentially, by using their cache of dry powder to write larger equity checks.

2

Acquirers will capitalize on attractive multiples

It is reasonable to expect that M&A activity will continue with a more cautious tone, as it was headed toward the end of the second quarter. However, deals will continue. Companies that set their sights on assets and have a clear, well-articulated strategic rationale for pursuing those deals will press ahead with the support of their shareholder bases. PE has ample dry powder at its disposal and has proven adept at capitalizing on market dislocations in the past. Indeed, the markdown in EBITDA multiples will make many opportunities all the more compelling over the next six to 12 months, and acquisitions made during this period promise to deliver when valuations recover.

“It is reasonable to expect that M&A activity will continue with a more cautious tone, as it was headed toward the end of the second quarter. However, deals will continue.

3

Going deeper on due diligence

There is no escaping the fact that risk sentiment has cooled. Acquirers are spending, and will continue to spend, more time on their due diligence processes, prepping on the regulatory side, forward planning for any potential issues that may arise and justifying their investment theses before bringing deals to their executive or investment committees for sign-off. Supply chain resilience will continue to be a focal point, and ESG will be further integrated into evaluations. Patient, steadfast bidders with deeper insight into their prospective deal targets will be rewarded for these efforts.

4

More hold-ups and aborted deals

This year has presented some truly blockbuster deals, from Microsoft's US$75.1 billion offer for Activision Blizzard, to the proposed US$71.6 billion Broadcom-VMware merger, and Elon Musk's bid for social media platform Twitter, valued at US$41.3 billion.

All three hit their own snags or show signs that they may not follow through. The Activision deal is facing scrutiny from the UK's Competition and Markets Authority (CMA), while Broadcom must wait for EU competition authorities to green-light the purchase, which is likely to take some time and may ultimately be blocked with mitigating conditions. And Elon Musk is seeking to walk away from the Twitter deal, which has landed that transaction in the Delaware courts. From regulatory hoops to further market volatility impacting bid-ask spreads, there is potential for more such deals to face complications.

5

Overseas opportunities to emerge

Amid the risk-off pivot and the higher rate outlook, the US dollar is the strongest it has been in 20 years, to the detriment of other major currencies. The euro has fallen to parity with the greenback, down approximately 20 percent over the past year. While a strong dollar is slowing foreign revenues and profitability at US multinationals, buyers with lots of liquidity will be incentivized to look overseas for potential buy opportunities. Not only have valuations come down, US acquirers can benefit as their cash stretches that much further when shopping for assets than was the case 12 months ago.

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M&A Explorer

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mergers.whitecase.com

WHITE & CASE
Debt Explorer

Debt Explorer combines an interactive research tool with exclusive commentary from White & Case partners. The tool, which uses Debtwire Par's primary issuance data from 2015 onwards, can be used to compare data and create custom charts about the value and volume of global leveraged loan and high-yield bond activity across all sectors.

debtexplorer.whitecase.com

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whitecase.com/cfius-firrma-tool

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