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M&A in 2012: Out with the Old, in with the New?

By Jane Goldstein, a Partner of Ropes & Gray LLP

While the existence of pent up demand (and cash) is creating hope among deal practitioners that M&A activity will increase in 2012, that hope has not turned into full blown optimism. Prognosticators range from predicting high activity levels to steady state with 2011 levels. However, while the level of activity may be difficult to predict, particularly in an election year, some trends do appear to be emerging that will drive M&A activity over the next 12 months.

Valuation Gap—Given the continued volatility of the markets, buy side and sell side continue to disagree on appropriate valuations. This will require creativity in successful deal making—likely through the use of earn-outs in the middle market in particular as well as other techniques (e.g., warrants, seller debt and contingent value rights). As we have seen historically, the use of earn-outs can be fraught with disagreements and disputes and therefore lawyers should be prepared for, and draft to anticipate, post closing disputes and possible litigation.

Hostile Activity—As we have seen in 2011, both strategic buyers (Vulcan Materials/Martin Marietta) and private equity sponsors (Sycamore Partners/Talbots's) have gotten bolder with respect to non-negotiated transactions. In addition—if market volatility continues, expect activist shareholders to use proxy season and other means to encourage spin offs, divestitures and the like. We all need to update our defensive (and offensive) toolkits—bring back the 80s!! (but not the fashions please). In that regard, we are fortunate to have the Delaware Chancery Court's Airgas decision in hand.

Regulatory Hurdles—From the outset, the Obama administration threatened tougher antitrust enforcement. They have stuck to their guns! 2011 saw the failed AT&T/T-Mobile deal and the payment of a \$3.5 billion reverse break up fee that “took CEO Randall Stevenson by surprise”. Strategic acquirers will be wary of taking similar risks and targets will be equally wary of failed transactions and becoming “damaged goods”. Expect more upfront regulatory work prior to deal announcement and pressure from clients for certainty before they will agree to large reverse break-up fees related to antitrust clearance. Regulatory challenges will also increase for companies as Dodd-Frank is implemented which has some expecting more transactions in the financial services sectors (See also “Distressed Assets”)

Distressed Assets—The post 2008 world may lead sellers to divest assets for balance sheet purposes when they would rather retain them, providing opportunities for buyers of these assets. We may start to see the

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effects of the so-called “wall of debt” as loans from the 2006/2007 heyday begin to mature. Buyers will need to move quickly and have capital in hand to win the most attractive of these assets. Particularly in Europe, many experts expect to see opportunities in real estate and other sectors.

Emerging Markets/Cross Border Deals—Opportunities lay in developing markets such as Asia, Latin America and Africa. Along with opportunities in emerging markets come regulatory challenges to entry by US buyers, as well as integration challenges. Some commentators predict significant activities from mature companies with proven technology entering these new markets.

Private Equity—Sponsors are chomping at the bit to get off of the deal sidelines and we saw some up-tick in activity in 2011. A combination of pent up capital, funds coming into their sunset years looking for exits and new funds being raised all point to increased activity for private equity. The debt financing markets will determine the complexion of deals in this space.

Public Company Sales Process—For those companies who either willingly or unwillingly dip their toes into the sales process, recent Delaware decisions in Airgas, Del Monte, Southern Peru and Openlane, among others, point towards the importance of process. Since buyers inherit the litigation in these deals, they would be well advised to monitor the activities of the targets’ Board.

It is always risky to style yourself as a crystal ball with the answers—we will see in 12 months (as we start our predictions for 2013) how well we did.

Happy New Year to all!

Forward-Looking Statements: Deal Market Trends for 2012

By David Fox, Bob Hayward, Daniel Wolf and David Feirstein of Kirkland & Ellis LLP

With the M&A market recovery losing steam in the second half of 2011, dealmakers are faced with increased global macro-economic jitters, election year uncertainty and tightened financing markets. But corporations and private funds still have capital to deploy, leading pundits and practitioners alike to be cautiously hopeful that the M&A market in 2012 may show signs of renewed vitality.

With that in mind, we look back at 2011 for lessons learned in the M&A space with implications for the coming year—from the birth of *Airgas* and further dismantling of staggered boards to the reported (but possibly not exaggerated) death of *Omnicare* and hyperbolized demise of proxy access.

Antitrust Regulators: “Not So Fast”

Antitrust risk is becoming one of the central topics of discussion among dealmakers. This year, three “3-to-2” combinations faced major opposition from U.S. antitrust agencies. Verifone’s acquisition of Hypercom was only cleared after settlement of a DOJ suit requiring divestitures to a financial sponsor (after the regulators rejected a proposed divestiture remedy involving sales to the third strategic player), while H&R Block’s acquisition of TaxAct failed after regulators successfully sued to block the merger of the two main rivals to TurboTax. Express Scripts’ proposed acquisition of Medco remains under review by the FTC after five months, with opposition to the merger mounting. Similarly, “4-to-3” mergers are meeting with continued skepticism. AT&T’s proposed acquisition of T-Mobile faces a February 13, 2012 trial date in the DOJ’s suit to block the transaction. The DOJ filing came only five months after the merger was announced, a notably compressed timetable compared to the year-long reviews afforded to the XM/Sirius and Comcast/NBC combinations.

While all four transactions undoubtedly represent significant antitrust gambles in any environment, it is clear that the regulatory environment has shifted to more muscular scrutiny and enforcement than we have seen in recent years, especially at the DOJ. We believe that dealmakers will factor into their decisions about taking (and allocating) antitrust risk their views on the likely impact of the political environment in the run-up to the November elections as well as their best guess as to the outcome thereof.