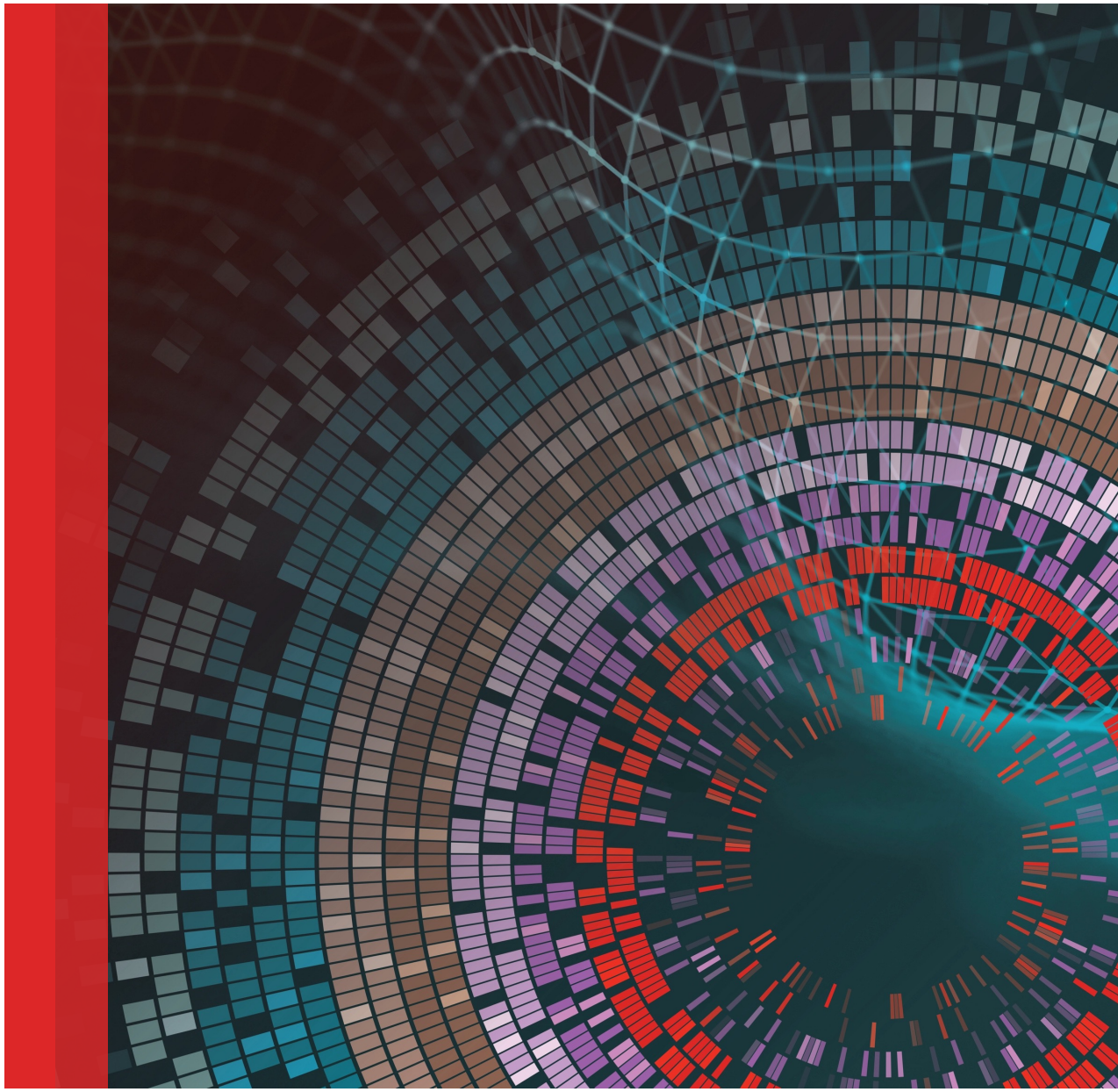
NORTON ROSE FULBRIGHT

Legal Considerations for M&A in an Election Year

ACC 2024 Annual In-House Symposium



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Speaker

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Mr. Hardee is a senior associate in Norton Rose Fulbright's Dallas office. He has experience representing public and private companies in equity and debt security offerings, merger and acquisition transactions, securities compliance work, corporate governance matters and private equity transactions.

His representative experience includes:

- A NYSE-listed investment management and wealth management services firm in its merger with the asset management division of an ASX-listed company for an equity value of $1.7 billion;
- A NYSE-listed exploration and production company in its merger with another NYSE-listed exploration and production company for a combined enterprise value of $2.0 billion;
- A Houston-based bank holding company in its initial public offering and Nasdaq Global Select Market listing;
- A portfolio company of a private equity firm with its acquisition of multiple roofing and building materials distributors across the United States;
- A Texas-based bank holding company with $856 million in assets in its merger with another Texas-based bank holding company; and
- A NYSE-listed staffing services company in connection with its acquisition of a provider of specialized IT consultants.

Agenda

- 2024 M&A Outlook
- Due Diligence and Timing
- Pricing Structures
- Deal Certainty

2024 M&A Outlook

Global M&A trends and risks 2024

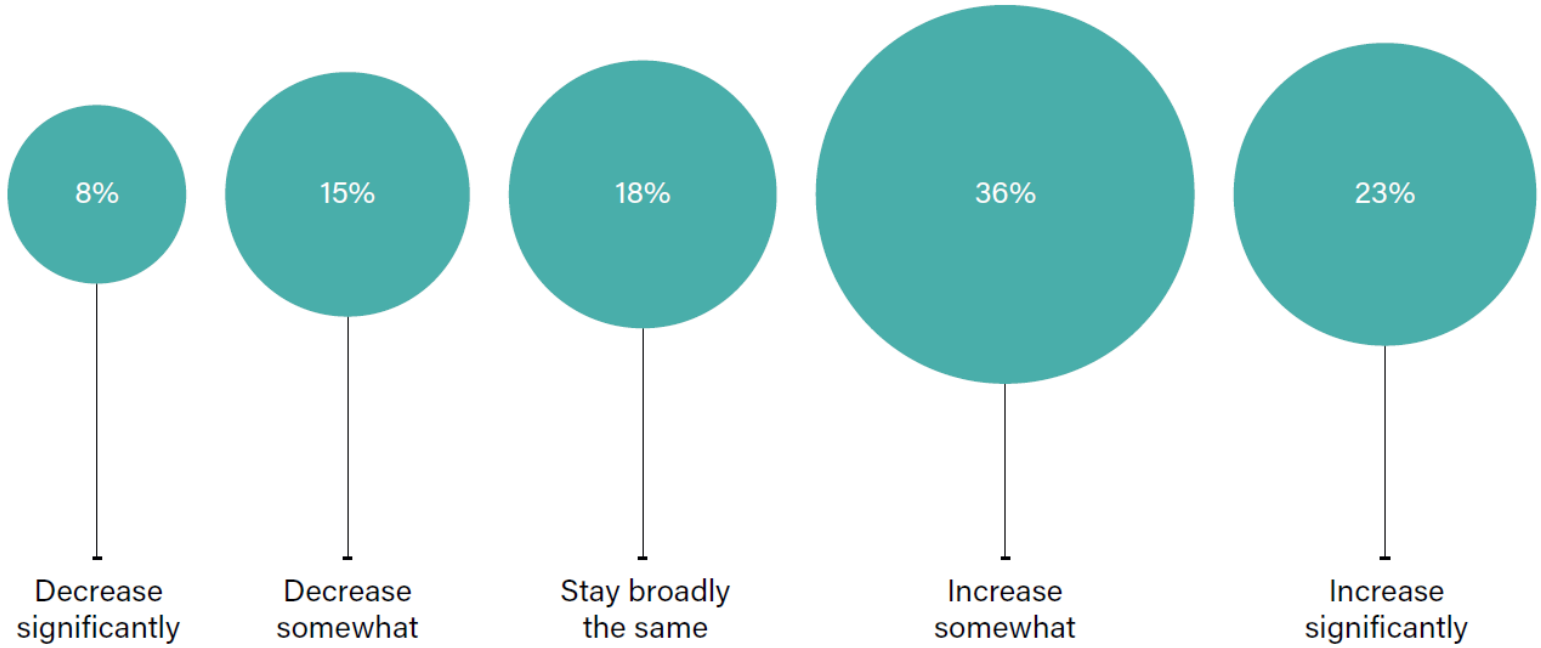
- In the fourth quarter of 2023, Mergermarket, on behalf of Norton Rose Fulbright, surveyed 200 of the most senior leading executives on the subject of global M&A trends and risks
- Respondent group included 100 C-suite and other top-level executives (e.g., CEO, COO, Managing Partner, Chief Investment Officer, Head of M&A, Director of M&A) from multinational corporates, 50 from large private equity firms, and 50 from major investment banks
- 40% headquartered in the US and Canada, 25% in Asia, 20% in Europe and the Middle East, 10% in Australia, and 5% in Africa.
- All respondents had participated in at least one large M&A deal across multiple continents and multiple sectors over the past two years.

Cautious optimism amid continued uncertainty in M&A

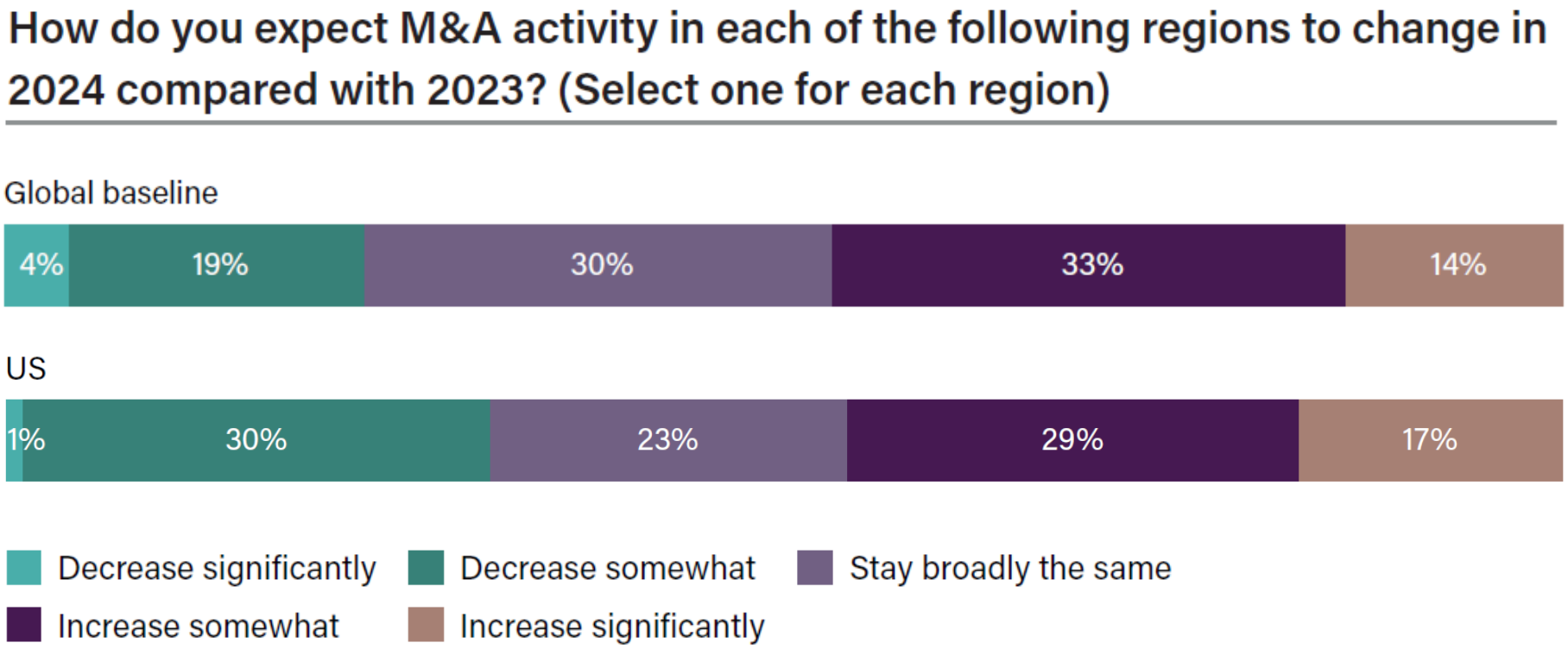
Deal Drivers:

1. **Industry Consolidation**
2. **Growth of new products and services**
3. **Ongoing pursuit of digital transformation**

How do you expect your organization's appetite for M&A in 2024 to compare to your appetite for M&A in 2023? (Select one)



Cautious optimism amid continued uncertainty in M&A, cont.



Five major trends that will define M&A globally in 2024

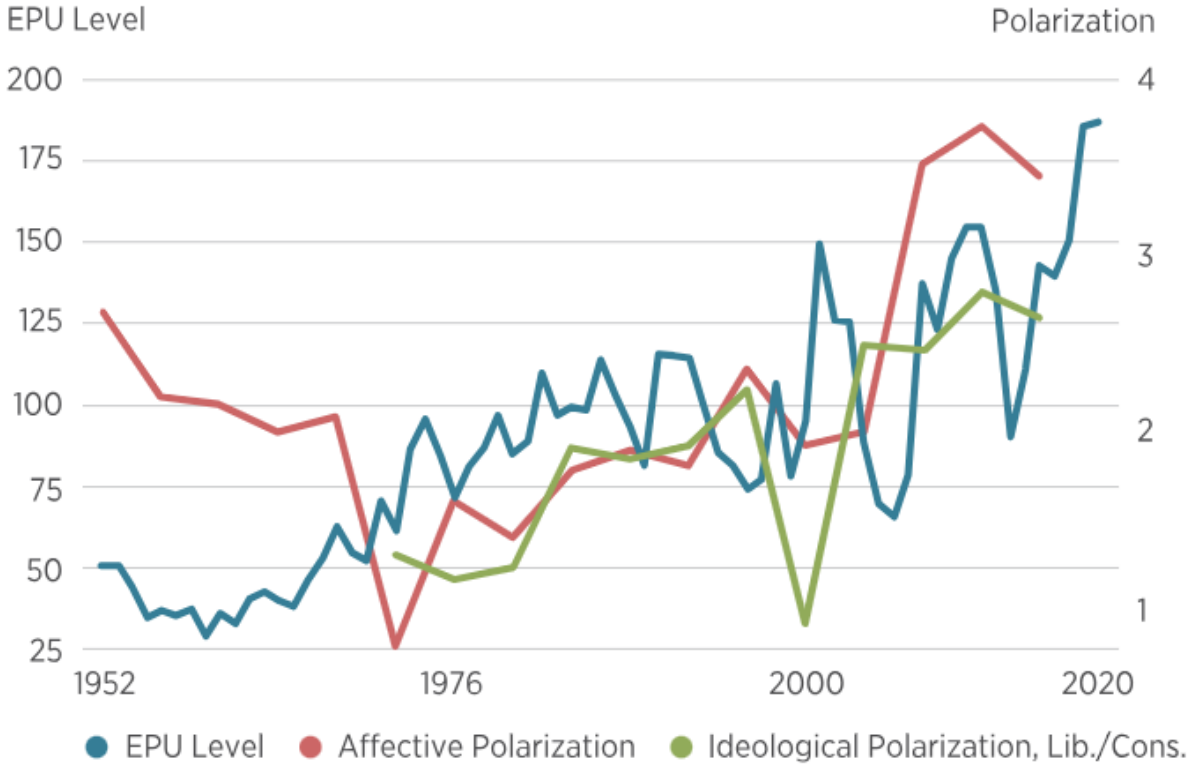
1. Doubling down on growth
2. Shoring up supply chains
3. ESG data will become critical
4. PE activism is on the rise
5. Tackling valuation gaps

Major elections as headwind for 2024

> "The ongoing conflicts and further geopolitical tensions in Eastern Europe and the Middle East, coupled with upcoming elections in a number of key countries including the US, make it difficult to predict the level of cross-border M&A activity for 2024."

Ayşe Yüksel Mahfoud, Global Head of Corporate, M&A and Securities at Norton Rose Fulbright

Major elections as headwind for 2024, cont.



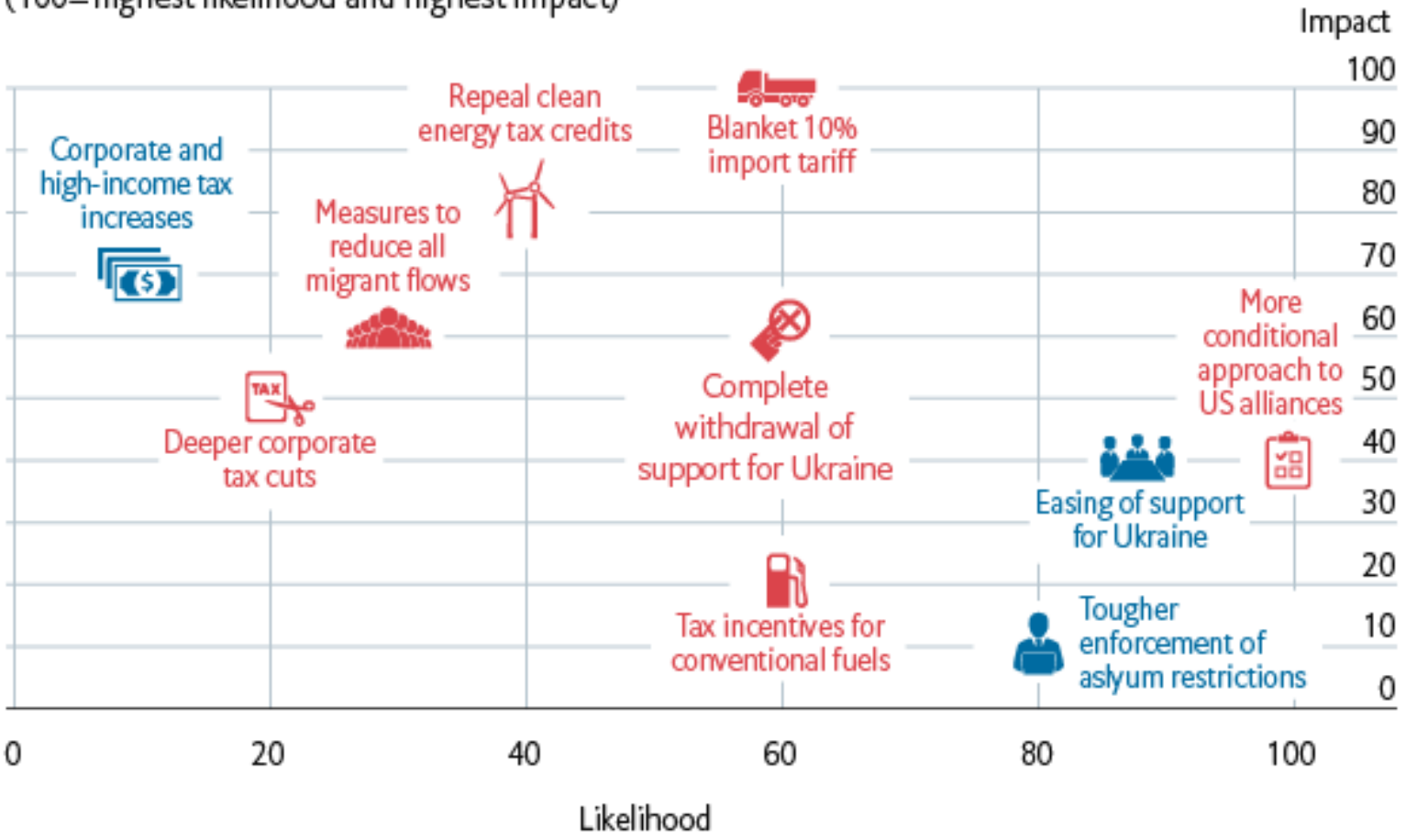
Note: Time series of the level of policy uncertainty and a measure of affective polarization in the US for elections 1952-2016. Policy uncertainty (the left axis) is measured using the level of the EPU normalized so that the mean level between 1985 and 2009 is 100, and then averaged across months within each year. For 2020, we only include data until February. Affective polarization is measured by the mean absolute difference in affect between parties averaged over all respondents and weighted by demographic weights (right axis). Ideological polarization is an analogous measure, calculated as the mean absolute difference in ideological positions on a Liberal – Conservative scale, between parties averaged over all respondents and weighted by demographic weights (right axis). Policy uncertainty data from policyuncertainty.com, and our polarization data is created using the ANES.

Due Diligence and Timing

Due Diligence

- Due diligence is a wide-ranging investigation, examination and review of the business, legal and financial affairs of a company in connection with a corporate transaction such as M&A
- Questions to ask in an election year:
  - Does the target operate in a heavily regulated area? Is that an area where we have seen significant shifts under the prior administrations?
  - Are there governmental permits or approvals material to the operation of the target's business? Does a change in administration make receipt or maintenance of those permits or approvals more or less likely?
  - Does the target have a global presence? Does it have a presence any locations that are currently subject to geopolitical tensions or otherwise sensitive to changing foreign policy?
  - Does the target engage in governmental contracting? What percentage of its business is tied to governmental contracting?
  - Does the target operate in an industry that has been dramatically affected by the economic policies of the prior administrations?

Due Diligence, cont.



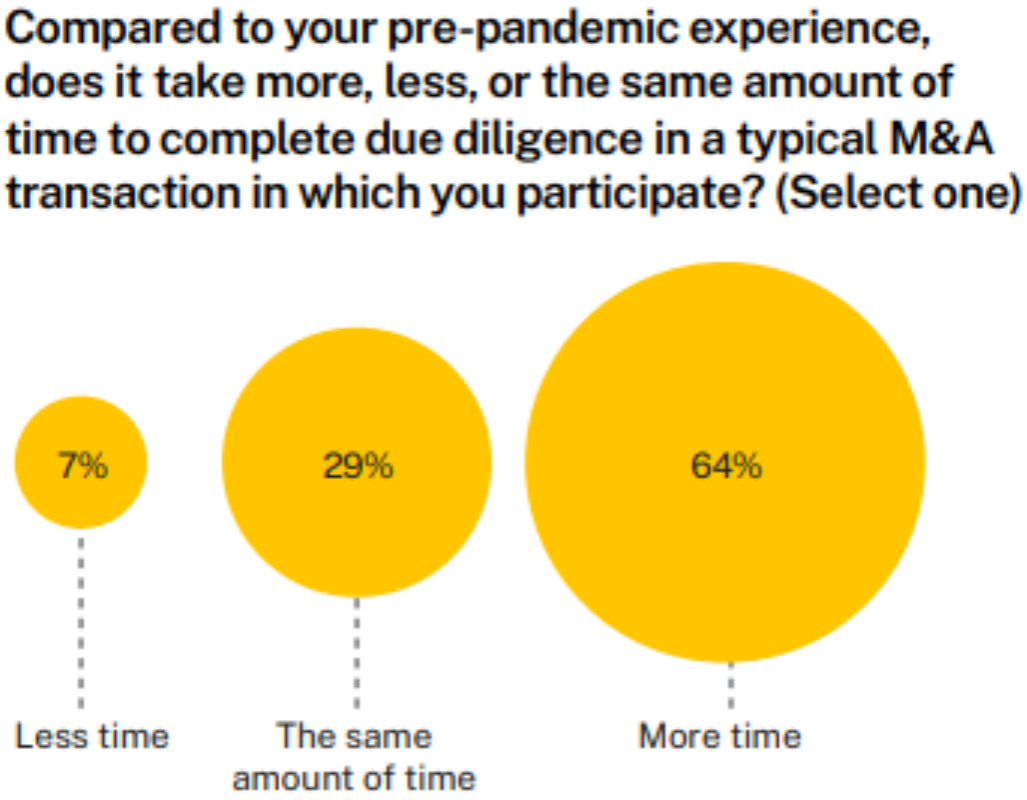
Note. Policies in red indicate those likely under Donald Trump; policies in blue are likely under Joe Biden.
Sources: EIU.

Due Diligence, cont.

- Depending on the target entity, political law compliance due diligence may be an area of heightened importance in election years
- Potential compliance areas to investigate:
  - Governmental gift-giving
  - Pay-to-Play laws and regulations
  - Campaign contributions
  - Corporate sponsored political action committees
  - Foreign Agents Registration Act
  - Lobbying activity

Timing

- Due diligence is taking longer, and elevated uncertainty may lengthen the process even further
  - Global M&A trends and risks 2024 report: “M&A due diligence is expected to be more extensive and the sources of data are increasing,” says the director of M&A at a Swiss corporate.
  - Report by SRS Acquiom and Mergermarket supports findings:
  - Implications for exclusivity agreements

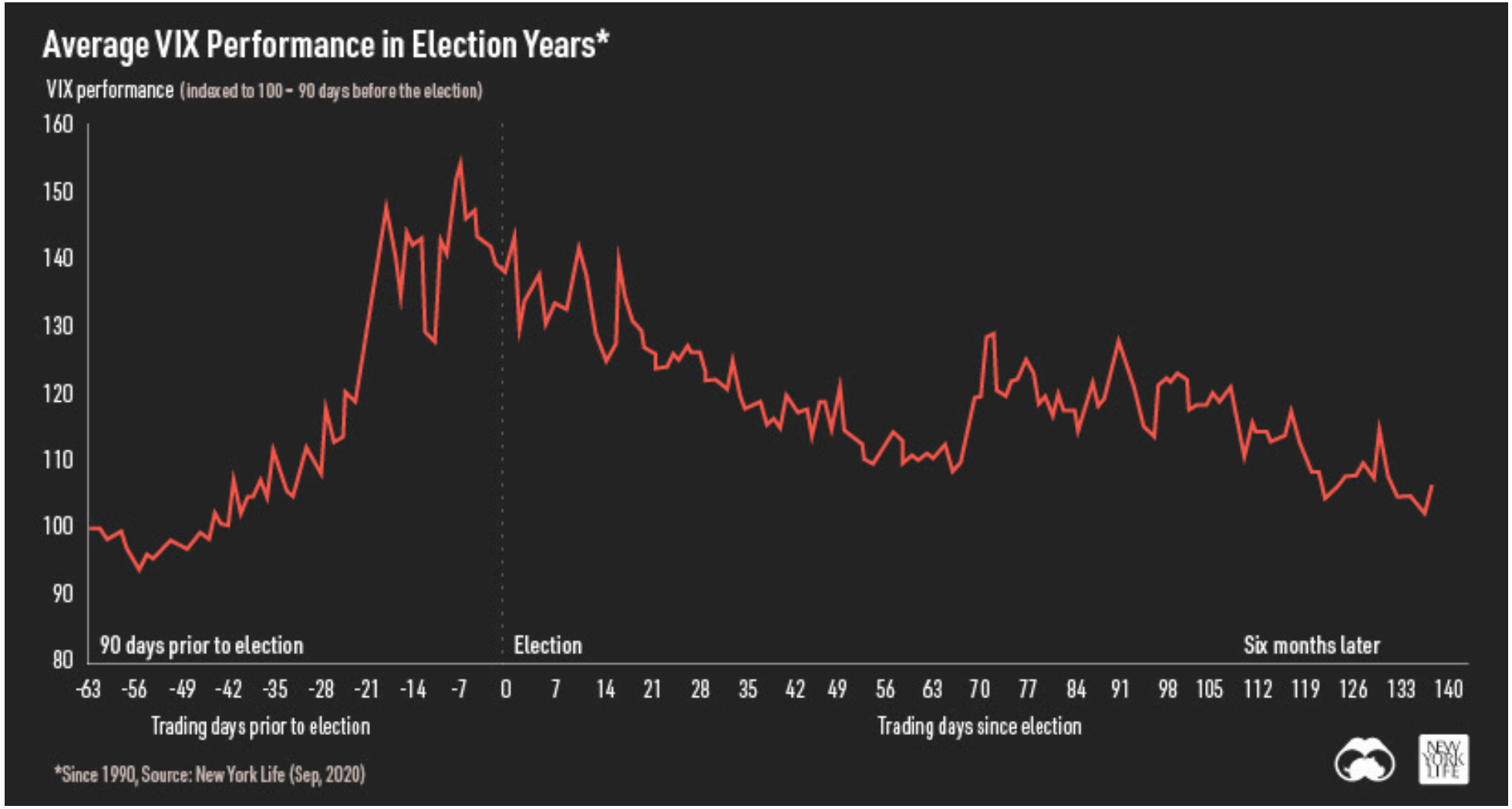


Timing, cont.

- Motivation and urgency to complete a deal may shift as the year progresses:
  - "The political environment that we are in – we are now in an election year – that is going to dramatically increase the volatility in the marketplace…. I think you are likely to see more M&A activity in the first half of the year. People are likely to hit the sidelines later. And then once the election is over and we understand the direction going forward, I think you are going to have a pretty robust snapback." *Paul Taubman, Chairman and CEO of PJT Partners*

Pricing Structures

Stock Market Volatility in Election Years



Addressing Market Volatility in Purchase Agreements

- **Fixed Exchange Ratio**
  - Each share of the target company's stock is converted into a fixed number of shares or a fraction of a share of buyer's stock
  - Parties know the amount of dilution that will occur with respect to buyer's shareholders
  - Buyer knows whether shareholder approval will be required under stock exchange listing requirements or its governing documents
  - Target company shareholders reap the benefits of a rise in buyer's stock price but also bear the risk of a decline
  - Buyer bears the risk of a rise in its stock price that results in it having to issue shares in the aggregate that exceed the target's value

Addressing Market Volatility in Purchase Agreements, cont.

- **Floating Exchange Ratio**
  - Target shareholders receive a fixed price, but the actual number of shares of buyer's stock to be issued is not fixed until close to closing
  - Parties do not know the amount of dilution that will occur with respect to buyer's shareholders
  - Buyer may not know whether shareholder approval will be required under stock exchange listing requirements or buyer's governing documents
  - Target company shareholders do not reap the benefits of a rise in buyer's stock price but also do not bear the risk of a decline

Addressing Market Volatility in Purchase Agreements, cont.

- **Collars to limit market volatility risk**
  - Fixed exchange ratio collars:
    - Helps protect the buyer from overpaying for the target due to a rise in its stock price
    - Helps protect the target shareholders from a decline in the buyer's stock price
    - Provides that there is no adjustment to the exchange ratio if buyer's stock is valued within a specified range at the time of closing. But if buyer's stock price rises above a negotiated cap or below a negotiated floor, there is an adjustment in the exchange ratio.
  - Floating exchange ratio collars:
    - Helps protect the buyer against significant dilution due to a decline in its stock price
    - Target shareholders still receive guaranteed value for their shares if the buyer's stock price stays within a negotiated range
    - Places a cap and a floor on the number of shares that the buyer may issue in the merger, and the exchange ratio continues to float if the stock price stays within the range of the cap and floor

Deal Certainty

Policy uncertainty as a predictor of deal termination

- Study published in *Finance Research Letters* examined whether the magnitude of policy uncertainty can explain the likelihood of deal termination[1]
- Used a comprehensive sample of U.S. M&A deals from 2000 to 2020
- Greater policy uncertainty may:
  - Lead to higher variability of future expected cash-flows
  - Lead to a downward revision of the perceived acquisition benefits and result in the acquisition becoming a negative net present value project
  - Eliminate the primary motive for an M&A deal
- Found that policy uncertainty is a significant predictor of the death of deals

1. Dang, Man, et al. "Does policy uncertainty predict the death of M&A deals?." *Finance Research Letters* 46 (2022): 102489.

Customary Closing Conditions

- Material Adverse Effect
  - **Stand-Alone**: *Since the date hereof, there shall not have occurred any Material Adverse Effect.*
  - **Back Door**: *Since the Balance Sheet Date, there has not occurred a Material Adverse Effect.* (Combined with a bring-down of the representations and warranties)
- Pre-Closing Covenants and Agreements
  - *Seller shall have performed in all material respects all of the covenants and agreements required to be performed by it under this Agreement prior to the Closing; provided, that, with respect to covenants and agreements that are qualified by materiality, Seller shall have performed such covenants and agreements, as qualified, in all respects.*

Customary Closing Conditions, cont.

- Representations and Warranties
  - *(i) The representations and warranties set forth in Article III of this Agreement other than the Fundamental Representations (without giving effect to any limitations as to "materiality" or "Material Adverse Effect" set forth therein) shall be true and correct in all material respects as of the date hereof and as of the Closing as though made as of such time (except to the extent such representations and warranties speak as of an earlier date, in which case such representations and warranties shall be true and correct in all material respects as of such earlier date), and (ii) each of the Fundamental Representations shall be true and correct in all respects as of the date hereof and as of the Closing as though made as of such time (except to the extent such representations and warranties speak as of an earlier date, in which case such representations and warranties shall be true and correct in all respects as of such earlier date).*
  - Bring-down standards (in all respects, in all material respects, *de minimis* qualifier, MAE qualifier) are negotiated by the parties

Customary Closing Conditions, cont.

- Covenant and representation conditions are often tied to the termination provisions
  - *This Agreement may be terminated at any time prior to the Closing… by Buyer by written notice to Seller if Buyer is not then in material breach of any provision of this Agreement and there has been a breach, inaccuracy in or failure to perform any representation, warranty, covenant or agreement made by Seller pursuant to this Agreement that would give rise to the failure of any of the conditions specified in Article VII and such breach, inaccuracy or failure has not been cured by Seller within thirty (30) days of Seller's receipt of written notice of such breach from Buyer.*

HControl Holdings LLC, et al. v. Antin Infrastructure Partners

- On December 3, 2022, Antin Infrastructure Partners entered into a merger agreement to acquire a group of privately held Florida broadband companies, collectively referred to as "OpticalTel," for $250 million.
- The merger agreement contained capitalization representations concerning the owners of OpticalTel, and buyers negotiated for a bring-down provision requiring that those representations be accurate *in all respects* at the time of closing.
  - Buyers struck sellers' *de minimis* qualifier, which provided that the "Fundamental Representations" (including the capitalization representations) "shall be true and correct in all respects (except failures to be true and correct as are, individually and in the aggregate, *de minimis* in nature)."
- After the parties entered into the merger agreement, a former OpticalTel employee claimed an ownership interest (valued at $215,000) in an OpticalTel subsidiary based on a 2004 software development agreement.
- Buyer determined that sellers breached the capitalization representations and terminated the merger agreement. Sellers filed suit for specific performance.

HControl Holdings LLC, et al. v. Antin Infrastructure Partners, cont.

- The court found that the former employee issue rendered the capitalization representations inaccurate, and that sellers failed to cure the issue. Sellers breached the merger agreement on this basis, rendering buyers' termination valid.
- Did not matter that the capitalization issue was minor relative to the deal value ($215,000 vs. $250 million)
- "Ultimately, it is not for this court to question the business wisdom of Buyers' decision to terminate. Buyers negotiated for the ability to terminate if the capitalization representations were not accurate in all respects, and this decision enforces that right."

Questions

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