

# M&A Trends Reshape the Legal Industry

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# Sectors and Companies on M&A's Leading Edge

By Lisa Singh

Global M&A activity demonstrated robust performance as the year drew to a close. With nearly \$5 trillion in value, deals driven by technology, communications, financial, and consumer non-cyclical industries led the way.

"The top driver for M&A activity is technology asset acquisition, as buyers, particularly strategics, seek to deploy 'buy-versus-build' strategies to maintain or gain competitive advantage," said Suzanne Saxman, chair of the M&A practice group at Seyfarth Shaw.

North America alone has posted \$2.5 trillion in M&A activity in 2018—more than half of all global M&A activity for the year—with 10 percent growth over last year, according to Bloomberg Law. Europe and Asia Pacific came in second and third, generating more than \$1 trillion and nearly \$900 billion, respectively.

Mature players leading industry consolidation also drove activity, particularly in media, communications, and health care. High-profile deals such as AT&T with Time Warner, The Walt Disney Company with 21st Century Fox (slated for completion in January), and Comcast with the British broadcaster Sky, merged entertainment production with distribution, and Cigna-Express Scripts and CVS-Aetna, coupled health insurance with pharmaceutical distribution, analysts note. Bold serial acquirers weren't necessarily the companies setting the tone, however.

"The biggest driver has been the fear of an overwhelming invasion by the tech giants, particularly Amazon and Google," said Charles Korsmo, professor of law at Case Western Reserve University. "They are the firms that are 'leading' M&A activity, in a sense, even if they are not the ones making the big purchases."

Talent acquisition is also spurring M&A considerations, particularly in a tight labor market.

"Buyers will also continue to employ M&A as a quick entry point to new markets," said Saxman of Seyfarth. "M&A will also be used strategically by some buyers as a tool to secure supply chains and respond to trade regime changes and tariffs."

Meanwhile, cross-border deals remain strong.

"The energy industry is one to keep an eye on in 2019, having seen the highest cross-border deal value of all sectors in [the third quarter], at \$71 billion," said Sarah Shaw, partner at Hogan Lovells. Continued recovery in oil prices, growing private equity and investment fund activity across the sector, and renewable energy growth are all contributing factors, she added.



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## **Dramatic market declines could shift focus to new markets.**

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However, geopolitical tensions loom large, particularly in high-tech industries.

“The semi-conductor industry is Exhibit ‘A,’” Korsmo said, citing Broadcom’s proposed purchase of Qualcomm, blocked by the U.S., and Qualcomm’s purchase of NXP, blocked by China. High-stakes losses are increasing the need for coordination among global partners.

As cross-border deals become a bigger share, and as more regulated businesses become involved, said Peter Harwich, partner at Latham & Watkins and member of the firm’s M&A group, “We see clients increasingly recognizing the imperative of close coordination early in the transaction planning and structuring process among experienced multidisciplinary and multijurisdictional teams of regulatory and antitrust specialists with deep industry knowledge.”

Adam August, partner in the corporate, M&A, and securities practice group at Holland & Knight, said, “Law firms need to be full-service and scalable, with resources that are knowledgeable about cutting-edge nuances in regulatory regimes.” He cited recent changes in the policies of the Committee on Foreign Investment in the United States as one such factor in client considerations.

With opportunity comes potential pitfalls. Regulatory developments in the U.S. alone contributed to nearly 15 percent of deals between public and private entities terminated as of the third quarter.

Among additional transactions, the German pharmaceutical company Fresenius dropped its \$4.3 billion agreement to purchase an American generic pharmaceuticals manufacturer, due to regulatory compliance and market performance concerns—a decision backed by the Delaware Court of Chancery.

“This [court decision] amounts to something of an earthquake, as no buyer had ever before been permitted to walk away from a deal due to a material adverse change clause being triggered, certainly in Delaware—by far the most important corporate law jurisdiction—and to my knowledge, anywhere else,” said Korsmo, who anticipates renewed attention to the design of clauses and the mutual risk that the buyer and seller assume before closing.

He stressed the importance of target boards disclosing all potential problems that could arise, to avoid a catastrophe before closing.

Furthermore, market performance is crucial to consider.

“Deal advisors need to be more attuned to the form of consideration being paid in a deal,” Korsmo said. “Where a substantial portion of the merger consideration is stock in the acquirer, target boards need to consider whether and how to protect their stockholders from dramatic declines in the acquirer’s stock price.”

Dramatic market declines could shift focus to new markets.

“The volatility of the public stock markets makes the middle market all the more attractive for investors and business owners,” said August of Holland & Knight.

Citing industrial, commercial, and consumer services sectors, as well as technology services, Saxman said, “In the middle and lower middle market, a huge number of private industrial and other businesses owned by baby boomers continue to enter the M&A market.

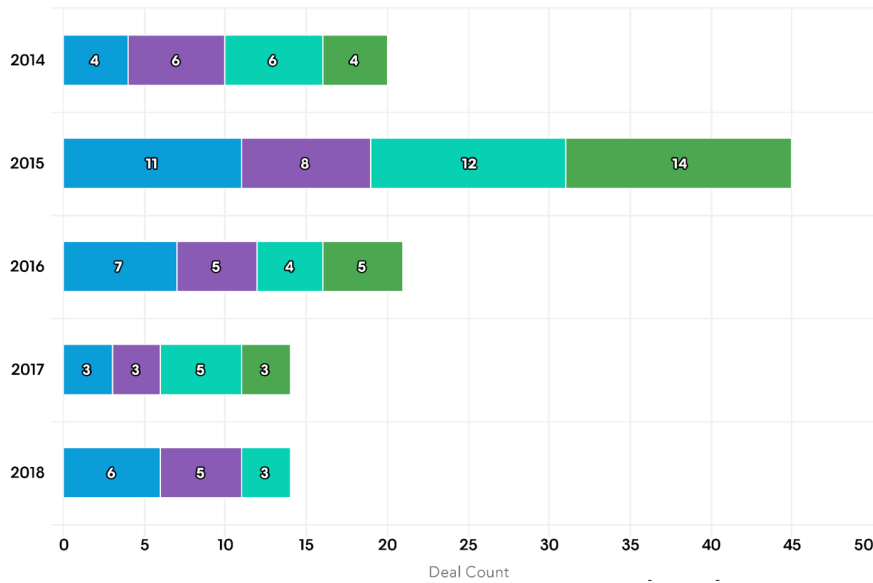
“Positive trends are likely to continue into 2019, particularly in the middle market, driven by companies actively redefining their business portfolios and seeking to achieve competitive advantages through M&A transactions.”

Lisa Singh is a writer specializing in business and technology matters

## M&A - Quarterly Mega Deals

U.S. Targets as of Q3 2018

■ Q1 ■ Q2 ■ Q3 ■ Q4

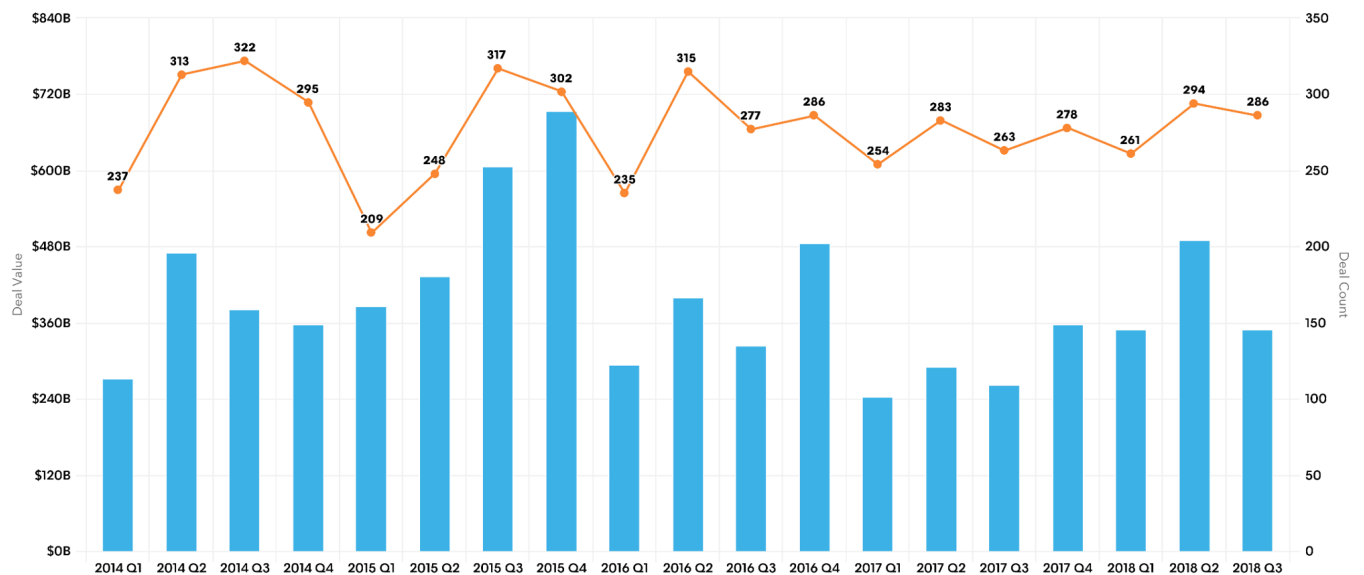


Source: Bloomberg Law

## M&A - U.S. Targets

Deal Count & Value as of Q3 2018

■ Deal Value (USD) ■ Deal Count



Source: Bloomberg Law

# New Law Guides M&A Investment and Security Priorities

By Lisa Singh

The Foreign Investment Risk Review Modernization Act, which was passed in August, will cast a wider net over the mergers and acquisitions playing field. The new law reflects the most substantive change in more than a decade to the process in which acquisitions receive approval from the Committee on Foreign Investment in the United States.

The new reporting requirements could turn disclosures of these deals into a more complex and time-consuming task, experts say.

“For covered transactions, the new requirements could add weeks, and maybe months, of delay to many transactions before they can close,” said Kevin Wolf, a CFIUS member during the Obama administration and current partner with Akin Gump’s international trade practice.

Transactions that previously were deemed low-risk could be significantly affected. This includes non-U.S. acquisitions of small U.S. technology companies.

“On any given day, scores of these M&A transactions were not being notified to CFIUS,” said Harry Clark, chairman of the global trade and compliance practice at Orrick. “Now parties to many of these transactions will be required to notify CFIUS, even if, frankly, CFIUS isn’t very interested in them.”

While previous regulations focused on the assessment of national security risk posed by a foreign person acquiring control of a U.S. business, the new law expands this scope to include influence from non-controlling foreign investments in U.S. businesses involved in critical infrastructure and technologies, those handling sensitive personal information of U.S. citizens, and certain real estate transactions, including undeveloped land, near government sites.

The law is slated for full implementation no later than March 2020. The Treasury Department, which chairs CFIUS, has issued two interim rules: The first lengthens a transaction’s review period from 30 to 45 days, and the second establishes a temporary pilot program requiring parties to transactions involving critical technologies to notify CFIUS before closing. The latter includes the option to provide a short declaration allowing for an expedited, 30-day process for most transactions. But it’s not guaranteed.



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The added scrutiny and steep penalties for noncompliance—as much as the value of the transaction, for both the buyer and the seller—are prompting a reexamination of transaction structures.

“With the influx of sovereign wealth and other foreign investment in U.S. private equity funds, many private equity investors are now tripping over CFIUS requirements, even when a U.S.-based fund is investing in a U.S.-based target, if their underlying investor base includes foreign entities,” said Kevin Robbins, cofounder of a Washington, D.C., area consultancy that advises investors and companies across national security and civilian marketplaces. Sidecar investment arrangements are also a focus in this environment.

Antonia Tzinova, a partner in the international trade practice of Holland & Knight, said, “Private equity firms with passive foreign participation have been shielded from CFIUS jurisdiction, provided the foreign subscription is truly passive and control is fully within the hands of U.S. nationals.”

Meanwhile, the current environment may shut out more foreign buyers, especially Chinese and Russian ones, Robbins added. He cites the increased scrutiny of Chinese companies buying U.S.-based cloud-hosting companies to exert influence.

“Some of the real estate clauses in FIRRMA take direct aim at these transactions, since the hosting deals can sometimes look like innocent real estate plays,” Robbins said.

FIRRMA’s reach isn’t limited to Chinese investments. “Most investments in critical technologies and infrastructure have been from our closest allies... U.K., Canada, and EU countries,” Tzinova said. “While there is an added layer of review, these types of investments will likely continue if they make business sense.”

Still, U.S. buyers may face “more muted” competition from foreign buyers, said Bob Kipps, managing director of aerospace and defense-focused investment bank KippsDeSanto. Where competition is strong, foreign buyers may include a risk premium over a U.S. buyer’s offer to win over a U.S. seller, he said.

The broad definition of “control” under CFIUS requires due diligence at the outset, experts say. “Involve your CFIUS counsel before you sign the purchase agreement,” Tzinova said. “And be ready to be flexible in adopting a deal structure that might allow the investment to go through.”

There are additional considerations that are important.

“For the U.S. business, consider its [U.S. government] contract work, proximity to government facilities, and sensitive research or information held by the U.S. business,” Wolf said.

“For the foreign buyer, consider its ownership structure, any foreign government ties, links to sanctioned parties, and agenda for the U.S. business,” he said. “Determine whether non-controlling foreign investors gain broad rights, informational access, or involvement in certain decision-making.”



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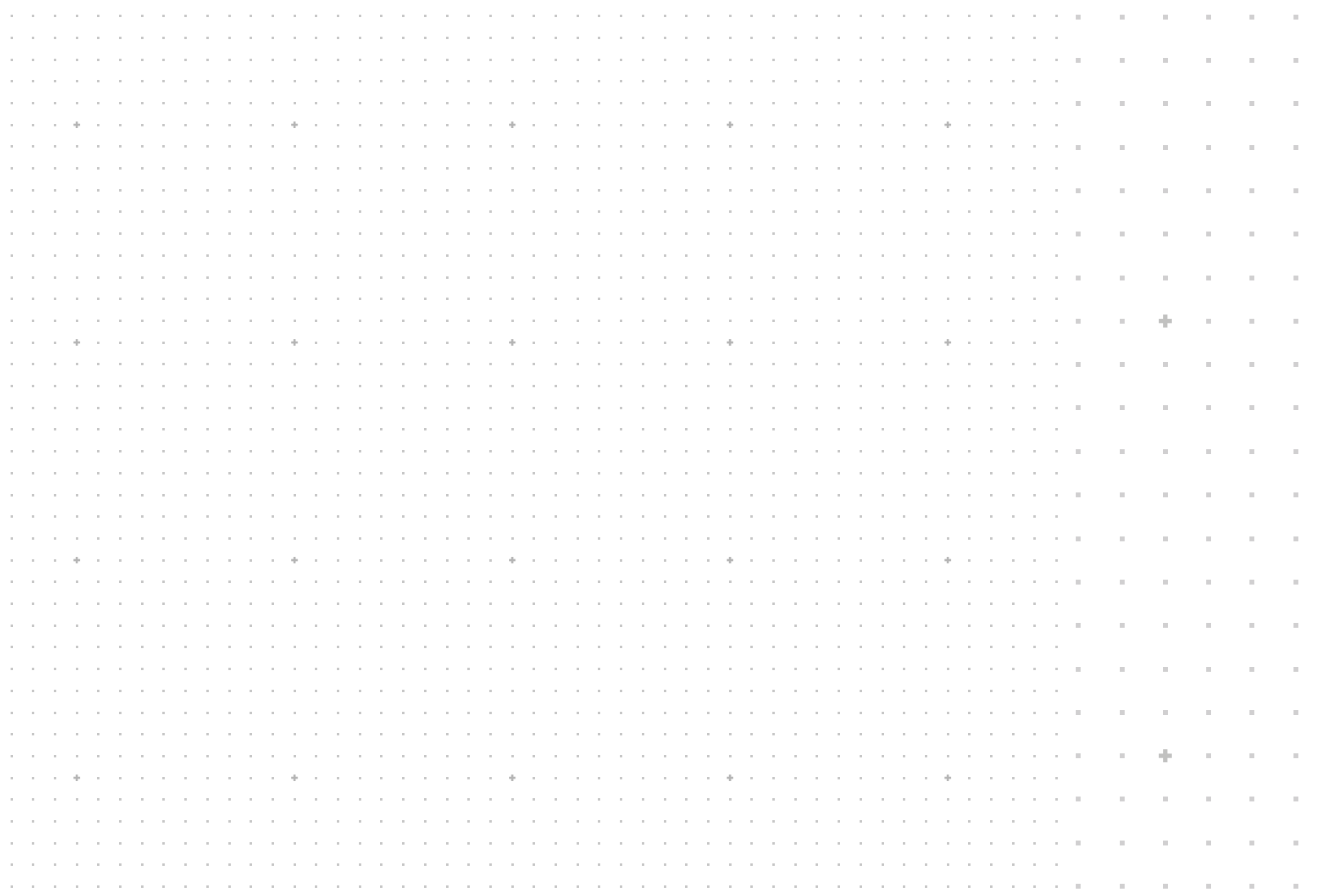
As FIRRMA settles into practice, timeline issues may eventually ease.

“While everyone has been focusing on the expanded CFIUS jurisdiction,” Tzinova said, “FIRRMA introduced some procedural changes and allocated resources to CFIUS, which hopefully will speed up the review process for transactions that do not warrant [being] blocked.” Additionally, regulatory refinement and guidance are likely to occur, experts say.

“I think virtually everyone would agree they’re overbroad, they’re catching too many transactions,” said Clark of Orrick. In the meantime, M&A activity will proceed, yet with an expanded scope of review for transactions.

“It’s just a complication that parties will go through to complete a transaction,” Clark said. “There may be delays—and a hassle factor, by virtue of the need to notify CFIUS—but the deal will normally close.”

*Lisa Singh is a writer specializing in business and technology matters.*



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