The M&A LAWYER

June 2022 ▪ Volume 26 ▪ Issue 6

IN APPRAISAL CASES, COURT OF CHANCERY INCREASES DEAL PRICE-BASED VALUATION IF EVIDENCE SHOWS PRE-CLOSING CHANGE

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For the purposes of a statutory appraisal under Delaware law, a corporation's fair value is determined "on the date of the merger"[1]—in other words, at closing, not signing. However, deal terms, including price, are typically agreed upon months in advance of completion, and the value of the corporation can change during that span. In 1996, the Delaware Supreme Court addressed this issue in the appraisal context for the first time, holding that changes in value to the corporation as a going-concern prior to closing must be included in the valuation.[2]

When the Delaware courts began using the deal value as a starting point in valuing companies (as opposed to the traditional discounted cash flow method),[3] they had to determine whether the deal price should be adjusted to account for any changes in circumstances between signing and closing. Until recently, there have been only a handful of cases addressing this valuation issue, and the courts in most cases declined to adjust the deal price, finding there was a lack of evidence to show a change in value.[4]

Then, in 2019, the Court of Chancery issued back-to-back decisions that suggested expert evidence may be helpful in that context. In the first case, appraising the value of Columbia Pipelines Group, Inc.,[5] the court declined to make an adjustment because petitioners failed to "suggest a means of adjusting the deal price,"[6] but said that "[p]erhaps an expert could have constructed a metric."[7]

Nine days later, the Court of Chancery appraised Stillwater Mining Company based on the deal price less applicable synergies.[8] The court declined to adjust the deal price in large part because, much like in *Columbia Pipeline*, the *Stillwater* petitioners failed to present expert testimony regarding how the increased price of some metals increased Stillwater's value.

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Court of Chancery Adjusts Deal Price Due to Post-Signing Increases in Value

In two cases in 2021 and 2022, however, the Court of Chancery increased a deal-price-less-synergies valuation due to a change in corporate value between signing and closing. In both cases, the court relied on expert evidence where the potential change in corporate value may not have been reflected in the deal price. These cases, discussed below, provide guidance for directors, officers and advisors negotiating transactions.

In 2021, *In re Appraisal of Regal Entertainment Group*,[9] the court determined that the deal price ($23) minus synergies (yielding a fair value of $19.23) was the most reliable indicator of fair value. However, after the merger agreement was signed but before the transaction closed, U.S. corporate tax rates were lowered. Regal agreed that the tax reform increased the corporation's value, but argued that the increase was not as large as the petitioners claimed.

Both parties relied on expert testimony regarding the increase in value. The court agreed that the lowered tax rate was part of the "operative reality" of Regal at closing and that an upward adjustment was warranted. Regal argued that the upward adjustment should be discounted because a portion of the increase was factored into the deal price, but the court disagreed. Although Regal provided evidence of market commentary about the impact generally of the lower tax rates, the court required specific evidence about Regal.[10] The court added $4.37 to result in a fair value of $23.60, slightly above the deal price.

In 2022, the Court of Chancery again adjusted a deal-price-less-synergies valuation ($44.29), this time due to outperformance of projections and analysts' expectations. In *BCIM Strategic Value Master Fund, LP v. HFF, Inc.*,[11] after signing, the corporation had a significant earnings beat and there was evidence that the increased performance would continue into the future.

Relying in part on expert evidence, the court found that the corporation's "outperformance was both more significant and durable,"[12] distinguishing it from *In re PetSmart*.[13]

The court noted that the projections the board relied on when it negotiated and approved the trans-

The M&A Lawyer
West LegalEdcenter
610 Opperman Drive
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(ISSN#: 1093-3255)

action at $49.16 per share did not anticipate the increased performance, and the valuation analysis of the corporation's financial advisor "did not incorporate value from the Company's pipeline of deals, which suggested that the Company would perform better than budgeted."[14] The court increased the deal price less synergies number by $2.30 for a fair value determination of $46.59.

Takeaways

- In recent appraisal cases, the Chancery Court has shown a willingness to find fair values in excess of the deal price if petitioners can prove that a corporation increased in value between signing and closing. On the other hand, the court has indicated that a company's value may also *decrease* if new information is negative.

- A petitioner must provide sufficient evidence, including possibly expert analysis, in order to convince the court an adjustment is warranted. On the company side, meanwhile, absent explicit evidence, the court may decline to find that a board considered possible future increases in value when negotiating a deal price. Defense lawyers should consider this in formulating their fact and expert discovery strategies, as both sides carry the burden of proving their cases in an appraisal action.

- If a board negotiating a transaction is aware of a pending market or legal change that has the potential to alter a corporation's value, it should consider that and document its deliberations regarding that issue, particularly where appraisal rights may be available.

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ENDNOTES:

[1]*Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 299 (Del. 1996).

[2]*Technicolor*, 684 A.2d 289 at 299.

[3]*See* our May 8, 2019 client alert, "Supreme Court Reinforces Deal Price Minus Synergies as 'Strong Indicator' of Fair Value," (https://www.skadden.com/insights/publications/2019/05/insights-the-delaware-edition/supreme-court-reinforces-deal-price) and our May 9, 2020 client alert, "Court of Chancery Continues To Rely on Market-Based Metrics in Appraisal Decisions" (https://www.skadden.com/insights/publications/2020/05/insights-the-delaware-edition/court-of-chancery-continues-to-rely).

[4]*Union Illinois 1995 Inv. Ltd. Partnership v. Union Financial Group, Ltd.*, 847 A.2d 340 (Del. Ch. 2004); *In re PetSmart, Inc.*, C.A. No. 10782-VCS (Del. Ch. May 26, 2017).

[5]*In re Appraisal of Columbia Pipeline Grp., Inc.*, Consol. C.A. No. 12736-VCL (Del. Ch. Aug. 12, 2019).

[6]*Columbia Pipeline Group*, C.A. No. 12736-VCL, Slip Op. at 95.

[7]*Columbia Pipeline Group*, C.A. No. 12736-VCL, Slip Op. at 95.

[8]*In re Stillwater Mining Co.*, Consol. C.A. No. 2017-0385-JTL (Del. Ch. Aug. 21, 2019).

[9]*In re Appraisal of Regal Entm't Grp.*, Consol. C.A. No. 2018-0266-JTL (Del. Ch. May 13, 2021), *judgment entered*, (Del. Ch. May 28, 2021).

[10]*Regal*, Consol. C.A. No. 2018-0266, JTL Slip Op. at 125.

[11]*BCIM Strategic Value Master Fund, LP v. HFF, Inc.*, C.A. No. 2019-0558-JTL (Del. Ch. Feb. 2, 2022).

[12]*HFF*, C.A. No. 2019-0558-JTL, Slip Op. at 70.

[13]*In re PetSmart, Inc.*, 2017 WL 2303599 (Del. Ch. 2017).

[14]*HFF*, C.A. No. 2019-0558-JTL, Slip Op. at 25.

BANK REGULATORS FOCUS ON FINANCIAL STABILITY FACTOR TO REEVALUATE LARGE BANK MERGERS

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In 2021, banks, including regional banks, engaged in significant levels of merger activity as they sought, in large part, to gain efficiencies of scale in order to enhance offerings and thus compete with larger institutions. The total deal value for bank mergers and acquisitions in 2021 reached a 15-year high, including 13 announced deals with values above $1 billion.[1] However, greater regulatory scrutiny has slowed large bank merger activity in the first quarter of 2022, with only one deal announced with a value above $500 million.[2]

Bank regulators have recently engaged in steps to reconsider their historical review processes for mergers, citing, among other items, the financial stability factor added to the Bank Merger Act and the Bank Holding Company Act by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") as a basis for their current reform efforts.

For the Bank Merger Act, Dodd-Frank's statutory language requires that the regulator consider "the risk to the stability of the United States banking or financial system" when assessing a proposed transaction, while for deals subject to the Bank Holding Company Act, Dodd-Frank mandates that the Federal Reserve Board consider "the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risks to the stability of the United States banking or financial system."[3]

Regulators generally have applied these statutory requirements by considering risks with respect to the stability of the U.S. banking or financial system as a whole; for example, the Federal Reserve Board, in its order approving the merger of BB&T Corporation and SunTrust Banks, Inc., noted, "[a]n organization's size is one important indicator of the risk that the organization may pose to the U.S. banking or financial system. [. . .] In this case, the Board has considered measures of the combined organization's size *relative to the U.S. financial system*, including the combined organization's consolidated assets, consolidated liabilities, total leverage exposure, and U.S. deposits."[4]

The use of the financial stability factor as pretext for further reconsideration and potential revision of bank merger regulatory review processes appears inconsistent with this historical "impact on the U.S. economy" approach, and indeed may be adverse to that historical approach by inhibiting regional and superregional banks from effectively competing with the largest U.S. financial institutions.

OCC and FDIC Regulatory Activities

On April 1, 2022, Michael J. Hsu, the Acting Comptroller of the Currency, spoke before the Wharton Financial Regulation Conference regarding the resolvability of large regional banks.[5] In his speech, he points to a gap in resolvability for so-called "large regionals,"[6] which are not subject to the heightened resolvability requirements that apply to the eight U.S. global systemically important banking organizations ("U.S. GSIBs"). Expressing a concern about financial stability if a large regional needed to be resolved, Hsu suggests that large regionals be subject to resolvability requirements similar to those applicable to the U.S. GSIBs, including adopting a single-point-of-entry ("SPOE") resolution strategy, requiring sufficient bail-in-able long-term debt at the parent (so-called total loss-absorbing capacity, or "TLAC"), and ensuring "separability."

Hsu acknowledges in his speech that it "made sense" that these requirements were initially placed only on GSIBs. However, because large regional banks are significantly larger and more complex than they were a decade ago, even though large regional banks do not need to be "subject to the full set of resolvability requirements for GSIBs," Hsu suggests that the aforementioned three approaches would give the government more options in order to plug "a gap in our financial stability defenses."[7]

Hsu notes that "[m]any of the reforms needed to effectuate those changes on a permanent basis would have to be done by the Federal Reserve and FDIC and would require rulemakings." However, in the interest of time, Hsu suggests that in order to oblige large regional banks to adopt these requirements sooner, the Office of the Comptroller of the Currency ("OCC") is reviewing and contemplating an interim alternative option, which is to "condition approval of a large bank merger on actions and credible commitments to achieving SPOE, TLAC, and separability."[8] Hsu reiterated many of these points in a speech at Brookings on May 9, 2022.[9]

Hsu's speech comes on the heels of several recent developments related to bank mergers. On July 9, 2021, President Biden issued a sweeping Executive Order on Promoting Competition in the American Economy ("Executive Order") asking for the "revitalization of merger oversight" and more extensive scrutiny of bank mergers.[10] Additionally, on March 25, 2022, citing the Executive Order, the Federal Deposit Insurance Corporation ("FDIC") published a request for information soliciting comments regarding the application of the laws, practices, rules, regulations, guidance, and statements of policy that apply to merger transactions involving one or more insured depository institution.[11] Both Hsu and the FDIC point to their authority to regulate on issues impacting financial stability as the reason behind the suggested or contemplated changes to the agencies' approaches to bank mergers, as Dodd-Frank added financial stability as a factor in bank merger review.[12] Hsu's suggestion in his speech alluding to certain "actions and credible commitments" regarding resolution actions is one way in which the OCC could give effect to the financial stability factor in its merger review.[13] Although expressly focusing on large regionals or "super-regionals," there is no numerical test cited by Hsu that would preclude regional banks engaging in material transactions from becoming subject to at least a less stringent version of this approach.

In this article, we first provide additional background on SPOE, TLAC, and separability. Next, we summarize additional, related developments in the bank merger space. Lastly, we summarize potential implications for large regional banks, and potentially regional banks engaging in significant transactions, in the merger context.

Background on Heightened Resolvability Requirements

Hsu states in his speech that there is currently a gap in large bank resolvability between U.S. GSIBs and large regional banks. While Hsu acknowledges that it is "logical" that large regional banks are not subject to the same requirements as U.S. GSIBs around resolvability as these large regional banks are "not as big, complex, or interconnected as the GSIBs," he underscores that there needs to be more options to resolve a large regional bank and then, in apparent contradiction to his earlier statement, suggests those same heightened requirements be applicable to U.S. GSIBs.[14] Hsu asserts that with current requirements, should a large regional bank need to be resolved, the only viable option would be a purchase and assumption transaction with a GSIB, which Hsu describes as a "shotgun marriage" that would force the GSIB to become "significantly more systemic."[15] We note that Hsu seems to disregard that large regional banks must file viable insured depository institution ("IDI") resolution plans with the FDIC, and that Category II and III regional banks must still file credible section 165(d) parent company resolution plans with the FDIC and the Federal Reserve Board.

Nevertheless, Hsu identifies three approaches, each already applicable to U.S. GSIBs, that would give the government additional options to resolve a large regional bank: implementing an SPOE resolution strategy, complying with TLAC requirements and restructuring in order for business lines and/or assets to be "separable."

SPOE Resolution Strategies

SPOE has become the prevailing approach to resolving the U.S. GSIBs and is now the strategy expected from regulators. SPOE resolution strategies are designed to eliminate the need for a government bailout and to minimize the contagion caused by a banking organization's failure, thereby addressing systemic and moral hazard risk. As Hsu acknowledges, in an SPOE resolution, only the top-tier parent company would fail; all of the material subsidiaries would continue to operate and function, "thus avoiding the chaos of multiple proceedings."[16] Under this approach, losses would be imposed on shareholders and long-term creditors of the top-tier parent holding company without the need for additional taxpayer or government support. By imposing losses on long-term creditors and by requiring holding companies to recapitalize and provide liquidity support to material operating subsidiaries that conduct critical operations, the SPOE strategy also helps to minimize contagion risk to the financial system. We note that the U.S. GSIBs have had to make significant adjustments to their business-as-usual structure and operations in order to facilitate a successful SPOE strategy, such as ensuring they issue sufficient external loss-absorbing long-term debt at the parent company, as discussed in the next sub-section on TLAC.

TLAC Requirements

The Federal Reserve Board adopted a "TLAC" rule designed to facilitate an SPOE resolution strategy. The rule requires the U.S. GSIBs to hold a minimum amount of capital and eligible long-term debt ("LTD") at the top-tier holding company and to maintain a "clean" top-tier holding company that facilitates the SPOE strategy by prohibiting or limiting the ability of the parent holding company to enter into certain financial arrangements that could impede the firm's orderly resolution. The purpose of the capital and long-term debt requirement is to ensure losses are absorbed by the parent company's shareholders and creditors and not taxpayers or the government. Hsu states that TLAC "serves as an important buffer, so that if the firm fails, private investors absorb the firm's losses and are 'bailed in' instead of taxpayers footing the bill for a bailout."[17] In order to comply with the TLAC rule, U.S. GSIBs had to make adjustments to the liabilities and other arrangements entered into by their parent holding companies.

Separability

Hsu states that to be separable, banks "must identify lines of business and/or large portfolios that can be sold quickly in stress or in receivership, and operate them so that such a sale can be effectuated quickly, ideally over a weekend. In other words, the firm must be able to be broken up." Hsu adds that "[i]n most large financial groups, this is not a given. Business lines or portfolios that seem naturally separable are often structured and operated in ways that make it quite difficult to sell them quickly for value."[18] Hsu does not acknowledge that large regional banks already focus on separability, as they must address separability in their IDI resolution plans with the FDIC, and Category II and III regional banks must present a credible resolution strategy in their section 165(d) parent company resolution plans submitted to the FDIC and the Federal Reserve Board.

Additional Bank Merger Developments

The OCC's internal review of its merger approval process to potentially condition approval on actions and commitments to achieve SPOE, TLAC, and separability comes alongside actions taken by the FDIC to review its own rules, guidance, and statements of policy that apply to merger transactions. In a request for information published in the Federal Register on March 31, 2022 (the "RFI"), the FDIC requests comment on its existing regulatory framework governing bank merger transactions, citing, like Hsu, Dodd-Frank's financial stability factor and the increase in large banking organizations as reasons for the current reexamination of the merger framework.[19] Comments were due by May 31, 2022.

For merger transactions subject to FDIC approval, the current FDIC Statement of Policy on Bank Merger Transactions (the "FDIC Policy Statement") lists four factors that the FDIC evaluates in its review of proposed transactions: (1) competitive factors, (2) prudential factors, (3) convenience and needs factor, and (4) the anti-money laundering record. Notably, the RFI recognizes that the FDIC Policy Statement does not address Dodd-Frank's financial stability factor.

The RFI presents 10 specific sets of questions for comment, including "[w]hat, if any, additional requirements or criteria should be included in the existing regulatory framework to address the financial stability risk factor included by the Dodd-Frank Act?"[20] Mirroring the concepts Hsu discussed in his speech, a different question asks, "Are there attributes of GSIB resolvability, such as a Total Loss Absorbing Capacity (TLAC) requirement, that could be put into place that would facilitate the resolution of a large insured depository institution without resorting to a merger with another large institution or a purchase and assumption transaction with another large institutions?"[21]

The questions also seek to possibly re-evaluate the existing factors used by the FDIC; one set of questions focuses on the convenience and needs factor in the FDIC Policy Statement. The breadth and depth of the questions for comment underscore that the FDIC is potentially undertaking a significant revamp of its merger approval process.

Separately, in an April 6, 2022 letter, Senate Banking Committee Chairman Sherrod Brown urges the OCC and the Federal Reserve Board "to join the FDIC and review and reconsider their approach to big bank mergers."[22] Brown's comments focus on the impacts that bank consolidation has had on communities, noting that "[i]t is time for regulators to transform their approach to better protect the consumers and small businesses that bank mergers leave behind."[23] Brown asks the OCC and Federal Reserve Board to initiate a public comment process on bank merger review, as the FDIC has done.

Implications and Next Steps

Kicked off by Biden's Executive Order in July 2021, it is clear there is a renewed focus on the regulatory framework for bank mergers. While it is uncertain what changes ultimately will be made to the standards and factors for merger approvals, large banks should be prepared for additional scrutiny during the merger application process, with potentially more requests for information or follow-up questions on submitted applications than may have been historically received. Such additional scrutiny is likely to extend the timeline for merger approvals, which should be accounted for when negotiating "drop dead" dates and other timing considerations in a purchase agreement. It is also possible that bank regulators will begin to condition approval of large and material bank mergers on representations or commitments provided in or alongside the merger application.

These representations or commitments could include requiring large regional banks to agree to changes to their organizational structure to accommodate a SPOE resolution strategy or to increase the percentage of long-term debt held at the parent entity to satisfy a minimum TLAC requirement.

The current regulatory and political scrutiny around bank mergers, and particularly the (perhaps undue) focus on the financial stability factor, may mean it will become more difficult for large and regional banks to pursue transactions on the same timeframes and with the same frequency as in recent years. As a result, regional and larger banks considering merger activity may wish to plan ahead for the issues that may be raised, so as to increase the chance of approval and shorten the time to a closing. Moreover, as regulators continue to develop proposals that could inhibit these transactions, banks should engage in the review and comment process through trade groups and, if appropriate, individual comment, to respond to requests for information.

ENDNOTES:

[1]*See* Seay, Lauren, Ali Shayan Sikander & Zuhaib Gull, *S&P Capital IQ, After Topping $75B in 2021, Bank M&A Shows No Signs of Slowing Down* (Jan. 13, 2022).

[2]*See* Seay, Lauren & Ali Shayan Sikander, *S&P Capital IQ, Increased Regulatory Scrutiny Puts Pause on Large Bank M&A* (Apr. 14, 2022).

[3]Codified to 12 U.S.C.A. § 1828(c)(5) (Bank Merger Act); 12 U.S.C.A. § 1842(c)(7) (Bank Holding Company Act).

[4]Federal Reserve Board, FRB Order No. 2019-16, "Order Approving the Merger of Bank Holding Companies" (Nov. 19, 2019) at 55 (emphasis added).

[5]Hsu, Michael J., "Financial Stability and Large Bank Resolvability," Wharton Financial Regulation Conference 2022, Philadelphia, PA (Apr. 1, 2022).

[6]Although Hsu does not define "large regional," he points to four large regionals today as having total consolidated assets of greater than $500 billion.

[7]Hsu, *supra* note 5, at 6.

[8]*Id.*

[9]Hsu, Michael J., "Bank Mergers and Industry Resiliency," Remarks at Brookings, Washington D.C. (May 9, 2022).

[10]*See* Debevoise In Depth, "Biden's Bank Merger Competition Order: FinTech Disrupts Its Presumptions by Disrupting the Marketplace" (Jul. 19, 2021), *available at* https://www.debevoise.com/insights/publications/2021/07/bidens-bank-merger-competition-order.

[11]*See* FDIC, FIL-11-2022, "FDIC Request for Information on Bank Merger Act" (Mar. 25, 2022), *available at* https://www.fdic.gov/news/financial-institution-letters/2022/fil22011.html.

[12]These developments may be responsible for slowing the pace of large bank M&A thus far in 2022. *See, e.g.*, Seay & Sikander, *supra* note 2.

[13]*See also* Baer, Greg, Bill Nelson & Paige Paridon, "Financial Stability Considerations for Bank Merger Analysis," Bank Policy Institute (May 16, 2022) (setting out a proposed framework with multiple factors for federal regulatory agencies to apply when assessing the change in financial stability resulting from a proposed merger).

[14]Hsu, *supra* note 5, at 4.

[15]*Id.* Hsu notably did not discuss regulators' ability to resolve financial institutions through the Orderly Liquidation Authority provided in Title II of Dodd-Frank.

[16]Hsu, *supra* note 5, at 4.

[17]*Id.* at 5.

[18]*Id.*

[19]FDIC, *Request for Information and Comment on Rules, Regulations, Guidance, and Statements of Policy Regarding Bank Merger Transactions*, 87 Fed. Reg. 18,740 (Mar. 31, 2022). In discussing the financial stability factor, the FDIC, like Hsu, also highlights the "significant challenges" that the failure of a large bank would present to the FDIC's resolution and receivership functions, noting that "given the increased number, size, and complexity of non-GSIB large banks, however, a reconsideration by the FDIC of the framework for assessing the financial stability prong of the BMA and focused attention on the financial stability risks that could arise from a merger involving a large bank is warranted." *Id.* at 18,741.

[20]*Id.* at 18,744.

[21]*Id.*

[22]Brown, Sherrod, Letter to Chair Pro Tempore Powell and Acting Comptroller Hsu (Apr. 6, 2022).

[23]*Id.*

FINDING THAT ALLEGEDLY CONFLICTED ACQUISITION SATISFIED ENTIRE FAIRNESS REVIEW, DELAWARE COURT OF CHANCERY REJECTS BREACH OF FIDUCIARY DUTY CLAIMS

By Alan S. Goudiss, Jeffrey D. Hoschander, K. Mallory Brennan, and Gregory Taylor

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On April 27, 2022, Vice Chancellor Joseph R. Slights III of the Delaware Court of Chancery entered judgment in favor of defendant, the CEO/co-founder and then-chairman (the "Chairman") of Tesla Motors, Inc. (the "Company"), following a trial on derivative claims for breach of fiduciary duty asserted by stockholders in connection with the Company's acquisition of SolarCity Corporation (the "Target").[1] Plaintiffs alleged that, at the time of the acquisition, the Chairman held approximately 22% of the Company's stock and was its controlling stockholder. He also purportedly was the chairman of the board and largest stockholder of the Target. Plaintiffs asserted that he caused the Company's allegedly conflicted Board to approve the deal—despite the Target's alleged insolvency—at a purportedly "patently unfair price."

Assuming without deciding that the Chairman was the Company's controlling stockholder and that a majority of the Company's Board was conflicted, the Court reviewed the claims under an "entire fairness" standard. Noting that the process was "far from perfect" and that "defense verdicts after an entire fairness review" are "not commonplace," the Court nevertheless found that the Company's Board "meaningfully vetted" the acquisition and the price paid was "entirely fair in the truest sense of the word"—and rejected plaintiffs' claims.

According to the decision, the deal involved the acquisition by an electric car manufacturer of a solar energy company in a stock-for-stock merger valued at approximately $2.1 billion when it closed in late 2016. Ultimately, 85% of all votes cast by stockholders of the Company were in favor. Plaintiffs alleged that, in addition to the Chairman, five of the other six directors of the Company were also conflicted with respect to the acquisition as a result of various financial and personal interests. Plaintiffs claimed that the Target was "insolvent," and that the Chairman caused the Board to approve the acquisition at an inflated price to "bail out" his investment.

After an 11-day trial, including fact and expert witness testimony, the Court found that, despite liquidity "problems," the "evidence leaves little doubt that [the Target] was still a valuable company" at the time of the deal. Explaining that entire fairness entails both fair dealing and fair price, the Court noted that price is the "paramount consideration."

As to the process, the Court concluded that notwithstanding the alleged involvement of the Chairman, there was an "indisputably independent director leading the way" and the Board was "well informed" and "placed the interests of [the Company's] stockholders ahead of their own." The Court noted that although the Board did not form a special committee of independent directors to negotiate the acquisition, it did condition the deal on an affirmative vote of a majority of the Company's disinterested stockholders, even though not required by Delaware law. The Company also dictated the timing of the acquisition, declining to explore the transaction when first proposed and instead pursuing it when it made sense for the Company and at a time when the Target's industry was facing "macroeconomic headwinds" that resulted in historic trading lows. In addition, the Court highlighted that the Board relied on "independent, top-tier" advisors. Indeed, the Court found that information discovered during the due diligence process was used by the Company to negotiate a lower price and that such price decreases "are strong evidence of fairness."

As to the price, the Court concluded that the Target was "far from insolvent." The Court noted that, while the Target was "cash-strapped to a dangerous degree," it had been able to raise billions of dollars from sophisticated financial institutions and its "cash challenges were ramifications of rapid growth, not market disinterest . . . or poor business execution." The Court added that the evidence indicated that the Company realized approximately $1 billion in nominal cash flows from the deal already and expects to realize at least $2 billion more.

The Court also determined that the fairness opinion and valuation work of the Company's financial advisor "accurately captured" the Target's value. In addition, the Court found that the market in advance of the deal was "sufficiently informed to reach a reliable assessment of [the Target's] value." Thus, the Company's acquisition, which was ultimately consummated at a small discount compared to the Target's unaffected stock price, was further evidence that the price paid was fair to the Company.

The Court also concluded that the acquisition was synergistic, including expected cost synergies of at least $150 million per year, as well as revenue synergies. The Court also pointed to "the astronomic rise" in the Company's stock price in the years following the deal and noted that the combination had "allowed [the Company] to become what it has for years told the market and its stockholders it strives to be—an agent of change that will 'accelerate the world's transition to sustainable energy.' "

The Court did "observe," however, that the Company potentially could have avoided "post-trial judicial second guessing" if it had adopted "more objectively evident procedural protections." For example, the Court noted that the Chairman could have "stepped away from the . . . Board's consideration of the Acquisition entirely," and the Board could have "formed a special committee comprised of indisputably independent directors, even if that meant it was a committee of one." The Court suggested that these procedures could have led to "business judgment deference."

ENDNOTES:

[1]*In re Tesla Motors, Inc. S'holder Litig.*, C.A. No. 12711-VCS (Del. Ch. Apr. 27, 2022).

DELAWARE COURT ADDRESSES CLAIMS ARISING FROM HACKERS' THEFT OF MERGER CONSIDERATION

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After hackers targeted law firm emails and stole a portion of the merger consideration, the Delaware Court of Chancery found it was "reasonably conceivable" that an M&A buyer could be liable for not ensuring final payment reached target company shareholders.

On April 1, 2022, the Delaware Court of Chancery ("the Court") issued an opinion in *Sorenson Impact Foundation v. Continental Stock Transfer & Trust Company*, a case brought by target company shareholders in a merger transaction after hackers posing as the shareholders successfully redirected a portion of the merger consideration to the hackers instead of the shareholders. The out-of-pocket shareholders sued the buyer, the target company (which survived the merger as a wholly-owned subsidiary of the buyer), and the paying agent responsible for remitting payment of the merger consideration to the target's shareholders under a customary paying agent agreement with the buyer.

Vice Chancellor Glasscock, considering the defendants' motions to dismiss at the pleading stage:

- allowed breach of contract claims against the buyer to proceed on the grounds that it was "reasonably conceivable" (the relevant standard at the pleading stage) that the buyer had breached the merger agreement by not ensuring that final payment reached the shareholders;
- dismissed all claims against the paying agent due to lack of personal jurisdiction; and
- dismissed claims that the buyer was vicariously liable for the paying agent's breach of contract on grounds that Delaware law only recognizes vicarious liability for an agent's tortious conduct.

Background

The *Sorenson* case concerns the acquisition of Graduation Alliance, Inc. ("the Target") by Tassel Parent Inc., a subsidiary of funds managed by a private equity firm ("the Buyer"). In connection with the transaction, the Buyer entered into a paying agent agreement ("the PAA") with Continental Stock Transfer & Trust Company ("the Paying Agent") to engage the Paying Agent to send the merger consideration delivered by the Buyer to the Target's shareholders. After the Sorenson Impact Foundation and James Lee Sorenson Family Foundation (together, "the Sorenson Entities") properly tendered their securities in the Target to the Paying Agent along with a letter of transmittal directing the Paying Agent to wire their merger consideration to a bank in Utah, hackers intercepted emails between the Sorenson Entities and legal counsel on the transaction ("the Law Firm") and, posing as the Sorenson Entities, asked the Law Firm to direct payment instead to a bank account in Hong Kong in the name of HongKong Wemakos Furniture Trading Co. Limited.

In accordance with the terms of the PAA, prior to closing of the merger, the Buyer sent the Paying Agent a schedule of all the Target shareholders entitled to receive the merger consideration. The PAA required the Paying Agent to examine all letters of transmittal as well as the share certificates submitted to it by the shareholders to ascertain that they were properly completed. If the share certificates or letters of transmittal were not properly completed or if some other irregularity existed, the Paying Agent was required to consult with the Buyer. The Paying Agent could waive such irregularities, but only with the Buyer's written consent. In addition, the form letter of transmittal that the shareholders completed required that any shareholder requesting payment in a name other than the name on its stock certificate properly endorse the certificate and have the signature "medallion guaranteed" by a qualified guarantor.

When the Law Firm instructed the Paying Agent to revise the Sorenson Entities' letter of transmittal to make a payment to the bank in Hong Kong in the name of HongKong Wemakos, the Paying Agent discussed the issue with the Law Firm and offered the Law Firm three options: (i) provide the medallion guarantee; (ii) provide the Paying Agent with a letter of instruction from the Sorenson Entities including hold harmless language for the benefit of the Paying Agent and waive the medallion guarantee requirement; or (iii) change the name on the payment schedule to the HongKong Wemakos name. The Law Firm chose the last option, and the Paying Agent made the payment to the account in the name of HongKong Wemakos, resulting in the Sorenson Entities not receiving the merger consideration to which they were entitled.

Analysis

Buyer May Be Liable for Not Ensuring Payment to Target Shareholders

The Court, noting that "the amended Complaint pushes the Court to the limits of the leniency inherent in the modern doctrine of notice pleading," overcame two significant hurdles to reject the Buyer's motion to dismiss the Sorenson Entities' breach of contract claims.

First, the Court observed that the Sorenson Entities did not plead that the Buyer had breached the terms of the merger agreement but instead alleged that the Buyer had breached the terms of the letter of transmittal by failing to obtain a medallion guarantee in circumstances where it was required to do so. The Court noted that the Buyer was not a party to, and had not signed, the letter of transmittal and that the Court had previously held in *Cigna Health and Life Insurance Company v. Audax Health Solutions, Inc.* that letters of transmittal are not contracts. Nevertheless, the Court stated that in the context of pleading a breach of contract claim in Delaware, a plaintiff can make out a sufficient claim if the complaint contains "a short and plain statement of the claim showing that the pleader is entitled to relief," and that "specific facts need not be pled in order to make out an 'actionable claim,' and assessment of the stated claim should be 'liberally construed' so long as the defendant has 'fair notice' of the claim." Applying that forgiving standard, the Court found that the complaint gave sufficient notice to the Buyer that it was being sued for a failure to pay the merger consideration in violation of the merger agreement for the breach of contract claim to survive a motion to dismiss.

Second, the Court acknowledged that the merger agreement did not explicitly require the Buyer to make a payment of the merger consideration to the Sorenson Entities. Instead, it merely required the

Buyer to pay the merger consideration to the Paying Agent, which the Buyer had done. However, notwithstanding the plain text of the merger agreement, the Court held that it was "reasonably conceivable" (the applicable standard at the pleading stage) that the merger agreement "read holistically" could be interpreted to require the Buyer "to do more than make a payment to its agent, that is, to ensure payment to the 'entitled' shareholders."

No Personal Jurisdiction Over Paying Agent

The Court granted the Paying Agent's motion to dismiss for lack of personal jurisdiction. The Sorenson Entities asserted that, although the Paying Agent was neither a party to the merger agreement nor a signatory to the letter of transmittal, the forum selection clauses in those documents (both of which required litigation in Delaware) could be imputed into the PAA because the PAA attached the letter of transmittal as an exhibit, and the letter of transmittal in turn attached the merger agreement as an exhibit.

The Court rejected the Sorenson Entities' arguments because (i) the PAA did not specifically incorporate the forum selection clauses by reference or otherwise provide an "explicit manifestation of intent" to incorporate the forum selection clauses and (ii) the PAA contained a provision expressly denying that the Paying Agent was bound by any provisions of the merger agreement.

The Court also found that the Paying Agent did not have sufficient minimum contacts with the state of Delaware by virtue of providing services in connection with the merger of two Delaware corporations for the state to assert jurisdiction through its long-arm statute, and Delaware had no special interest in adjudicating a dispute over a "commonplace commercial contract" such as the PAA.

No Vicarious Liability for an Agent's Breach of Contract

The Court dismissed the Sorenson Entities' claims that the Buyer was vicariously liable for the Paying Agent's breach of the PAA on the grounds that under Delaware law, while a principal may be vicariously liable for *torts* committed by its agent, a principal cannot be liable for its agent's breach of contract or other non-tortious conduct. Although the Sorenson Entities did plead that the Paying Agent had committed the tort of negligence, the Sorenson Entities did not allege that the Buyer was vicariously liable in connection with that conduct. The Court implied that had the Sorenson Entities pleaded that the Buyer was vicariously liable for the Paying Agent's negligence, a vicarious liability claim may have survived a motion to dismiss.

Unjust Enrichment Claims

The Sorenson Entities also pleaded unjust enrichment claims against both the Buyer and the Target. Under Delaware law, unjust enrichment occurs where there is "(1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and impoverishment, (4) the absence of justification and (5) the absence of a remedy provided at law." While the Court noted that "it is difficult to see how Buyer can have liability apart from breach of contract here," it nevertheless "bow[ed] under the weight of precedent," citing the Court's recent decision in *Lockton v. Rodgers* (holding that the absence of justification prong can be satisfied by other claims brought by the plaintiffs) to decline to dismiss the unjust enrichment claims.

Status After the Ruling

As a result of the ruling, the Sorenson Entities' claims against the Paying Agent were dismissed, while their claims against the Buyer for breach of contract and claims against both the Buyer and the Target for unjust enrichment were permitted to proceed. The Court declined to rule on the Buyer's and the Target's motion to dismiss for failure to join the Law Firm as a necessary party, requesting that argument on that motion be supplemented to consider the additional question of whether the Paying Agent is a necessary party.

Implications

Sorenson highlights the need for M&A practitioners to be aware that sophisticated hackers who are familiar with the standard payment mechanics of merger transactions are looking to exploit the process of transmitting funds from the paying agent to shareholders. These hackers prey upon law firm associates, paying agent employees, and other individuals who are tasked with coordinating closing payment logistics, often in great volume and under significant time pressure. The plaintiffs in *Sorenson* argued that the defendants' actions were influenced by a "time crunch," and noted that the Law Firm did not consult with what it believed were the Target shareholders before giving the final instruction to the Paying Agent to change the name in the PAA payment schedule.

While all parties to an M&A transaction and their counsel and other advisors should do everything possible to ensure that protections are in place to prevent hackers from infiltrating their systems in the first place, ultimately individual practitioners must remain vigilant even in the haze of a time-crunched closing process for potential red flags, such as last-minute changes to payment instructions or letters of transmittal or failures to observe protective technical requirements, such as the need for a medallion guarantee.

Additionally, *Sorenson* puts M&A buyers on notice that their obligations may not end with payment to a paying agent. Indeed, the Court found that it was "reasonably conceivable" that the merger agreement in this case required the Buyer to ensure ultimate payment to the Sorenson Entities (despite the lack of any direct language to that effect). Buyers (and their counsel) may be obliged to see that payments ultimately reach shareholders, especially when potential irregularities arise or deviations from the express processes in transaction documents are considered.

While M&A practitioners and their clients can view paying agent agreements as technical form documents with little practical significance, *Sorenson* proves that these documents' terms can have important implications when unforeseen circumstances arise or in the event that increasingly sophisticated bad actors succeed in infiltrating a transaction. Buyers and paying agents should consider including language in their paying agent agreements and letters of transmittal entitling them to rely on the information provided by shareholders unless precise steps are taken to revise the letter. Doing so could lessen the perceived pressure to accommodate what appear to be last-minute changes from entitled shareholders.

Further, parties should not assume that Delaware courts will read into agreements choice of law or forum clauses that are not included in the agreements or incorporated by reference simply because there are significant Delaware contacts in other aspects of a transaction. If the parties' goal is to ensure that Delaware law and venue (or that of another jurisdiction) prevail, they should expressly include choice of law and forum clauses in paying agent agreements or expressly incorporate by reference the choice of law and forum clauses in the merger agreement or the letter of transmittal to ensure that the paying agent can be joined in any litigation that arises. Terms contained in an exhibit or attachment to an agreement will not be imputed into that agreement unless there is an "explicit manifestation of intent" for those terms to be incorporated.

Finally, *Sorenson* serves as a reminder that under Delaware law a principal (such as a party to an M&A transaction) can be held liable for the negligence or other tortious conduct of an agent (such as a paying agent), but not for an agent's breach of contract.

RECENT ANTITRUST DIVISION STATEMENTS SUGGEST CLOSE ATTENTION TO DEALS INVOLVING PRIVATE EQUITY

By Andrew C. Finch, Aidan Synnott, Joshua H. Soven, Matthew W. Abbott, and Sarah Stasny

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The federal antitrust agencies are increasingly focused on issues of particular relevance to private equity funds. In a memo last September,[1] the FTC Chair asserted that "the growing role of private equity and other investment vehicles invites us to examine how these business models may distort ordinary incentives in ways that strip productive capacity and may facilitate unfair methods of competition and consumer protection violations."

More recently, Jonathan Kanter, the assistant attorney general in charge of the Antitrust Division at the DOJ, has spoken about potential competitive issues in private equity deals, including roll ups, the involvement of private equity in divestiture remedies and enforcement of the law concerning interlocking directorates. In a recent interview with the *Financial Times*,[2] he said that private equity deals are "top of mind" for him and his staff.

Roll Ups

In the interview, Mr. Kanter stated that a roll up strategy is a "business model [that] is often very much at odds with" antitrust laws "and very much at odds with the competition we're trying to protect." As a result, he said, if the DOJ is "going to be effective, we cannot just look at each individual deal in a vacuum detached from the private equity firm." In line with these statements, funds can expect that they or their portfolio companies will increasingly be asked wide-ranging questions about strategies in certain merger reviews. More broadly, in light of Mr. Kanter's statements and the DOJ and FTC's recently issued call for comments on the agencies' merger guidelines (which asks whether "the guidelines' approach to private equity acquisitions [is] adequate"), it would not be surprising to see private equity roll ups addressed in future merger guidelines.

Acquisitions of Divestiture Assets

As we wrote in January,[3] Mr. Kanter has expressed some skepticism about divestitures as remedies in merger matters in general. He stated then that while divestitures will be an option in certain circumstances, in his view "those circumstances are the exception, not the rule." He returned to the topic of divestitures in a speech in April,[4] expressing a concern that "divestitures may not fully preserve competition across all its dimensions in dynamic markets." In that speech, he went on to single out private equity purchasers, saying that "too often partial divestitures ship assets to buyers like private equity firms who are incapable or uninterested in using them to their full potential." He continued this theme in the *Financial Times* interview, saying: "Very often settlement divestitures [involve] private equity firms [often] motivated by either reducing costs at a company, which will make it less competitive, or squeezing out value by concentrating [the] industry in a roll-up." Those involved in deals where a private equity fund is part of a potential remedy should take Mr. Kanter's assertions into account when advocating for the remedy.

Interlocking Directorates

In general, Section 8 of the Clayton Act prohibits a person from simultaneously serving on the board of two competing corporations unless the criteria for de minimis exceptions are met. Historically, when the DOJ became aware of a potential Section 8 issue (typically during review of a proposed transaction), the matter was often resolved by the director resigning from a board.

In certain instances, the DOJ issued a public statement about the matter. Recent statements by Mr. Kanter suggest that future Section 8 violations may be treated differently. In April, he gave a speech in which he suggested that the DOJ would "not hesitate to bring Section 8 cases to break up interlocking directorates."[5] He reiterated the Antitrust Division's attention to interlocking directorates in the *Financial Times* interview, saying "we're going to enforce" Section 8. These statements—along with Mr. Kanter's other statements about his willingness to litigate—suggest that Section 8 issues may be more onerous to resolve going forward. It may be that the DOJ will now insist on a consent decree, which would require a court filing, a period for public comment and eventual approval by a judge. As such, private equity funds should pay particular attention to potential Section 8 issues when structuring deals, and should periodically evaluate their portfolios for these issues as companies' businesses evolve. Indeed, companies that are not initially competitors may become competitors as product and service lines change.

ENDNOTES:

[1] https://www.ftc.gov/system/files/documents/public_statements/1596664/agency_priorities_memo_from_chair_lina_m_khan_9-22-21.pdf.

[2] https://www.ft.com/content/7f4cc882-1444-4ea3-8a31-c382364aace1.

[3] https://www.paulweiss.com/practices/litigation/antitrust/publications/antitrust-division-head-discusses-approach-to-merger-remedies?id=42238.

[4] https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-keynote-university-chicago-stigler.

[5] https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-opening-remarks-2022-spring-enforcers.

DISPARATE IMPACT: WINNERS AND LOSERS FROM THE NEW M&A POLICY

By Noah Joshua Phillips

Noah Joshua Phillips is a Commissioner on the Federal Trade Commission. The following is edited from his remarks at the Eighth Annual Berkeley Spring Forum on M&A and the Boardroom, held in San Francisco on April 27, 2022.

The traditional view of M&A (to which I subscribe) is that it is part of the way that companies grow (or shrink) and evolve, as assets move to the users that value them most highly. This market, which Henry Manne dubbed the "market for corporate control," also disciplines management and encourages competition.[1] Under this framework, the role of the antitrust enforcer is to determine which deals present threats to competition, block or remedy them, and—in keeping with Ronald Coase[2]—otherwise reduce transaction costs and minimize distortions to the market.

But to the new leadership at the antitrust agencies and their fellow travelers, that view is anathema. Their view of M&A boils down to three ideas. First, M&A generally produces little social value and a great deal of social cost.[3] Second, the costs include a wide swath of ills including lessened competition but also disadvantaged labor,[4] inflation,[5] and undermined democracy.[6] You name the problem, and there's a good chance some prominent antitrust-reform Progressive has blamed it on M&A.[7] Third, M&A is a privilege granted to companies by the government, rather than a natural part of commerce.[8]

Much of the change to merger policy over the last 15 months is taking place in the context of merger review under the Hart-Scott-Rodino (HSR) Antitrust Improvements Act of 1976. If you share the hostile view of mergers to which antitrust reformers subscribe, then HSR—a process Congress designed to help agencies spot and address ahead of time deals that lessen competition—looks more like an opportunity to slow or stop M&A activity in general. And the latter, what I've called elsewhere the "repeal of Hart-Scott-Rodino,"[9] is exactly what we are seeing. Using HSR this way has several benefits:

> First, it allows you to talk about it, broadcasting hostility to M&A that has a positive branding effect for enforcers and may also have some deterrent effect for M&A;
>
> Second, you can sow uncertainty and run up the cost of getting deals done, taxing M&A and making the market for corporate control less efficient;
>
> Third, these strategies can be accomplished without courts; and
>
> Fourth, it shields enforcers from political accountability for enabling M&A.

These "features" explain the merger control policies adopted over the last 15 months that together constitute the only real novelty thus far in the Biden Administration's approach to M&A. The changes are not particularly well-calibrated to make antitrust enforcement more efficient or effective, and indeed—as Jan Rybnicek's faithful reporting on Twitter of actual merger enforcement statistics shows—it has not been.[10]

Like all policies, the new M&A policies being deployed by the agencies include tradeoffs. And one such tradeoff, I think, deserves particular notice. Contra the professed goals of Progressive antitrust reformers, to rein in the biggest companies, the gratuitous taxes on M&A being imposed by the antitrust agencies are regressive, hitting smaller companies the hardest. Policies designed in the name of "anti-monopoly" are disproportionately taxing companies that few would consider monopolies, making it harder for them to compete.

Taxing M&A

How are the agencies taxing M&A? Antitrust enforcement over the last 15 months has been anything but vigorous—indeed, it has been sclerotic. By that I mean not just fewer cases being brought, but a longer process with fewer decisions being made.[11]

The merger review process is already expensive. Merging parties typically end up paying hefty sums in attorney and consultant fees, not to mention the time spent internally to comply with agencies demands. One study estimated the median cost of Second Request compliance at $4.3 million.[12] That is separate and apart from the up-front expense of negotiating deals and conducting due diligence. Full-phase merger investigations can last from several months to a year or more. Unanticipated delays can impose costs beyond fees and distraction, like having to extend deal financing or losing key employees and customers—or even losing out on the deal.

While supporters of agency leadership cheer what they hope will be a deterrent to merging generally, these kinds of costs are felt more heavily by smaller firms. And that disadvantages them relative to larger ones, to whom the costs look more like a rounding error. The fact is that mergers are a way for smaller firms to join forces to compete more effectively and efficiently against larger rivals. Combining can put financially struggling firms on firmer footing, or improve the terms on which they can borrow to grow their business. Advisers to traditional retail grocers on M&A made a recent submission detailing how competition from the Amazons and Wal-Marts of the world was leading investors to flee traditional grocers, resulting in lessened investment, store closing, and bankruptcy.[13] While those hostile to M&A might discount this narrative, antitrust reformers have not been shy about basing their criticism of Amazon and Wal-Mart on the challenges faced by precisely these smaller kinds of companies.[14] If growth by M&A is deterred substantially, why would anyone believe that the giants would be the most hamstrung?

Beyond the drawn-out process, the Commission has adopted several policies openly taxing M&A in a way that does nothing for competition and also disparately impacts smaller players.

Early Termination

In the early days of the Biden administration, FTC leadership suspended early termination ("ET") of the initial HSR waiting period. ET is reserved for transactions that raise no apparent competitive concerns. The FTC told the public that it expected the suspension to be "temporary" and "brief," and justified it by citing the change in administrations and an "unprecedented volume of HSR filings for the start of a fiscal year."[15] That didn't make sense then. The uptick in filings had started long before, and the agency had not only managed it but prosecuted—under Chair Joe Simons—the most prolific merger enforcement in decades.[16] And presidential transition was nothing new. The justifications make even less sense now, over a year since the "temporary" and "brief" termination began. The number of HSR filings had *already dropped* 70% from the 2020 peak when the suspension went into effect,[17] and the Administration came into office more than a year ago.

The suspension of ET continues to delay what are, *by definition*, competitively innocuous deals. It is using the HSR process not to protect competition but rather just to tax M&A. These deals can help Americans, even save lives. The day before announcing the suspension, the Commission granted ET to Thermo Fisher's acquisition of Mesa Biotech.[18] The small biotech company had developed an innovative rapid-PCR-testing platform for the novel coronavirus, and combining it with Thermo Fisher's resources, scale, and distribution would better meet then-exploding demand for testing.[19] With America and the world struggling through the pandemic, the grant of ET just 24 hours before the suspension took effect was good for the public—and awfully convenient for the FTC when one considers the negative PR from holding up a deal that stood to improve COVID screening. This incident not only belies the misguided assumption that M&A offers nothing of value, it demonstrates that those impacted by anti-M&A policies are not just giant monopolies, but often small companies . . . and people who need help.

Ending ET accomplishes nothing for competition and nothing good for M&A. But there is another thing worth noting. By never granting ET, we, as enforcers, cannot be accused of "permitting" the deal. More on that soon.

Prior Approval

Another example of gratuitously taxing M&A is the new Commission policy on prior approvals, adopted in October with the vote of former Commissioner Rohit Chopra.[20] Under this policy, all consents require Commission prior approval for future transactions both by merging parties and divestiture buyers for 10 years. The Commission also threatens to impose restrictions for markets not at issue in the transaction.[21] The new policy warns merging parties that they are more likely to be slapped with prior approval provisions if they substantially comply with the FTC's compulsory requests in a full phase investigation. In marginally less ominous language, the Commission is saying: give up and don't make us investigate your merger, or we'll make you pay.[22] The Commission also holds out the prospect of pursuing prior approval remedies even after parties drop the offending deal, the precise embarrassing and wasteful conduct that led the agency to adopt a policy limiting prior approval requests in 1995.[23]

Giving the Commission a veto over future M&A and all the time it wants to render it imposes significant obligations on merging parties, and innocent divestiture buyers. It slows and chills future M&A activity whether it lessens competition or not. Perhaps those hostile to M&A rest easier now that Hikma Pharmaceuticals, a $2 billion generic drug manufacturer, cannot buy another injectable skin steroid without permission.[24] They are surely relieved that 30-employee XCL Energy cannot buy more land to drill in Utah without government approval.[25] But these two are hardly Pfizer and ExxonMobil. And say what you will, but requiring Price Chopper and Tops to obtain the FTC's permission before acquiring a supermarket in Vermont or upstate New York for the next 10 years is probably not keeping Amazon executives up at night.[26]

Meanwhile, after years of rhetoric claiming that antitrust enforcers are falling down on the job by insinuating that every large pharmaceutical deal or purchase by a large tech company must, somehow, be anticompetitive and unresolvable, are we not supposed to notice AstraZeneca's $39 billion acquisition of Alexion Pharmaceuticals,[27] Merck's $11.5 billion acquisition of Acceleron Pharma,[28] and Facebook's $1 billion acquisition of Kustomer,[29] each of which went through without any prior approval or other kind of obligation?[30]

Smaller companies are more likely to accede to prior approval requirements because they have less leverage and often need the deal more, and with a prior approval obligation their ability to engage in M&A will be less than their larger competitors. That is a competitive disadvantage to larger rivals. And let's not forget the divestiture buyers. We are punishing the companies (often smaller ones) that have done nothing but step up to help resolve a competitive concern. This is what Commissioner Wilson and I dubbed "bonkers crazy."[31]

Who does all of this help? One answer, as with the termination of ET, is agency heads who do not wish to be associated with "clearing" mergers. Prior approval requirements deter consents, not mergers. Among other things, they scare off better buyers of assets. Without a consent, there is nothing for enforcers to approve. Sure, this strategy probably will push a few otherwise settleable matters into expensive, uncertain litigation and force staff to review prior approval applications for transactions that would not otherwise merit investigation. Fine, companies will fix it first. And, yes, the agencies will be less effective and efficient as a result. But at least the leadership will be able to dodge some difficult and unpopular decisions. This is a political benefit, not a policy.

I am very concerned we are going to start seeing deals with divestitures but without consents. There are today murmurings in the private bar that the agencies are refusing to engage on remedies, and instead are conveying their competitive concerns and leaving it up to the merging parties to attempt a resolution. This is fixing it first with a wink and a nod—and no enforceable agreement with the government. As a result, the public loses out on the protections that a consent agreement provides—including, ironically, prior approval policy. Only agency heads, who get to avoid the appearance of blessing mergers, gain. Reading strident dissents about failed remedies for years, it never occurred to me that one solution might be neither blocking nor remediating deals at all.

Pre-Consummation Warning Letters

The final change to merger control I'll highlight is the promiscuous use of pre-consummation warning letters, sometimes called "close-at-your-own-peril letters." The point of HSR is to enable the antitrust agencies to review transactions, and block or remedy the anticompetitive ones, before they are consummated.[32] That is not always possible, of course. If the agencies do not expect to complete their review before the merging parties are free to consummate their deal, they will sometimes issue pre-consummation warning letters that typically inform the parties that the investigation is ongoing, may ultimately find that the merger is illegal, and the parties cannot avoid an enforcement action by consummating now.

When a merger presents legitimate competitive concerns and there is a good reason why the investigation will not be completed in time, I have no objection to issuing such letters. But last August, the Director of the FTC's Bureau of Competition announced a new practice of issuing these letters far more liberally.[33] By my count, of late, the FTC has sent warning letters in at least 60 investigations. Some of those are in matters where we haven't even begun to conduct an investigation. In others, the real investigation is over and we lack a reasonable basis to conclude the merger violates the law. But the letters say we're still investigating.

There is a bad government aspect to this. For those matters where we've decided there isn't a competitive issue to address, one of two things must be true. Either we are wasting staff's time and taxpayer dollars on needless investigation, or we are misrepresenting to parties what is really happening.

But to parties trying to make and implement M&A decisions, the result—and, I fear, the goal—is to sow uncertainty about the future. Uncertainty, in turn, discourages post-merger integration and investment. This effect is particularly harmful for small companies, which are more likely than larger firms to need M&A to become more efficient and competitive, and which will have a harder time remaining viable should their merger be unwound. How is that a good thing? Once again, there is a critical benefit to agency heads: because investigations never end, we can never be seen as approving the deals we are investigating.

How Is the M&A Tax Working?

If these various M&A taxes have borne fruit as strategies to stop more anticompetitive mergers, those fruit are not apparent. But the disproportionate burdens already are.

Are the big guys running scared? The *New York Times'* DealBook recently reported that while global M&A is down overall from last year—a natural and predictable corollary of plummeting equity values and rising interest rates—there has been a sharp increase in the value and volume of very large deals—*i.e.*, $10 billion or more—"despite increased scrutiny from antitrust regulators and other factors that dampened enthusiasm for smaller deals."[34] If that was the goal in the first place, it is very different from the rhetoric.

Conclusion

Policy involves tradeoffs. In their zeal to tax M&A however they can, especially in ways that courts cannot police, those running the antitrust agencies and their supporters are already inviting perverse consequences. They are driving up costs and sowing uncertainty that disparately impact smaller players, putting them at a competitive disadvantage to the biggest companies. And, apart from press releases and avoiding political accountability, what's the payoff?

Everything I have described involves the process for merger control. But substantive changes are surely coming, as the Antitrust Division of the Department of Justice and FTC undertake revisions of the merger guidelines. I am not opposed to this project in principle, and I am open to exploring well-supported, administrable changes to the 2010 Guidelines.

But the hostile mentality about M&A responsible for recent process reforms is a bad place to start, and I am concerned that bias is already skewing the Guidelines revisions. The January 18 Request for Information issued jointly by the DOJ and FTC solicits "specific examples of mergers that have harmed competition" but not of mergers that benefited competition. Or consider the "listening forums" undertaken by FTC Chair Lina Khan and Assistant Attorney General Jonathan Kanter, with the ostensible purpose of "hear[ing] from those who have experienced firsthand the effects of mergers and acquisitions beyond antitrust experts." Public sessions are great, but there is no transparency to me or the public about how the presenters—who have uniformly negative things to say—are being selected. This stands in stark contrast to countless past public hearings, where commissioners besides the Chair got input into who would speak.

Even well-crafted policy has unintended consequences. The reforms to the merger process already in place are not well-crafted, so it's little surprise the consequences have not been good. They are doing little for competition, weakening small companies vis-à-vis larger competitors, and serving only to support personal branding and lack of accountability at the agencies. While the RFI process thus far has left much to be desired, the antitrust agencies still have a choice.

Prudence dictates that any new approach to merger enforcement should be warranted by developments in legal and economic analysis, and only after a thorough evaluation of both the administrability and likely impact of that new approach. The process should be transparent. I urge my colleagues and DOJ leadership to proceed with care, and I encourage the public to participate. We've seen too many mistakes already.

ENDNOTES:

[1]Henry G. Manne, Mergers and the Market for Corporate Control, 73 J. POL. ECON. 110, 112 (1965); Noah Joshua Phillips, Comm'r, Fed. Trade Comm'n, Competing for Companies: How M&A Drives Competition and Consumer Welfare, Opening Keynote at The Global Antitrust Economics Conference (May 31, 2019), https://www.ftc.gov/system/files/documents/public_statements/1524321/phillips_-_competing_for_companies_5-31-190.pdf.

[2]R.H. Coase, The Nature of the Firm, 4 ECONOMICA 386 (1937); R.H. Coase, The Problem of Social Cost, 3 J.L. & ECON. 1 (1960).

[3]*See, e.g.,* Lina M. Khan, Chair, Fed. Trade Comm'n, Remarks Regarding the Request for Information on Merger Enforcement 2 (Jan. 18, 2022), https://www.ftc.gov/system/files/documents/public_statements/1599783/statement_of_chair_lina_m_khan_regarding_the_request_for_information_on_merger_enforcement_final.pdf ("While the current merger boom has delivered massive fees for investment banks, evidence suggests that many Americans historically have lost out, with diminished opportunity, higher prices, lower wages, and lagging

innovation."); U.S. Dep't of Justice & Fed. Trade Comm'n, Request for Information on Merger Enforcement 2 (Jan. 18, 2022), https://www.regulations.gov/document/FTC-2022-0003-0001 ("Finally, the agencies seek specific examples of mergers that have harmed competition, with descriptions of how the merger harmed competition, including how those mergers made it more difficult for customers, workers, or suppliers to work with the merged firm or competitors of the merged firm or made it more difficult for rivals to compete with the merged firm."); Sandeep Vaheesan, Merger Policy for a Fair Economy, LPE Project Blog (Apr. 5, 2022), https://lpeproject.org/blog/merger-policy-for-a-fair-economy/; Sanjukta Paul, A Democratic Vision for Antitrust, DISSENT (Winter 2022), https://www.dissentmagazine.org/article/a-democratic-vision-for-antitrust.

[4] *See, e.g.*, Marshall Steinbaum, A Missing Link: The Role of Antitrust Law in Rectifying Employer Power in Our High-Profit, Low-Wage Economy, ROOSEVELT INST. (Apr. 16, 2018), https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI-Missing-Link-Monopsony-brief-201804.pdf; BARRY C. LYNN, ANTITRUST: A MISSING KEY TO PROSPERITY, OPPORTUNITY, AND DEMOCRACY 13 (New Am. Oct. 2, 2013), https://d1y8sb8igg2f8e.cloudfront.net/documents/Antitrust.pdf.

[5] *See, e.g.*, Elizabeth Warren (@SenWarren), (Mar. 1, 2022, 9:47 p.m.), https://twitter.com/senwarren/status/1498852508487331850; Elizabeth Warren (@SenWarren), (Jan. 3, 2022, 12:13 p.m.), https://twitter.com/SenWarren/status/1478051819255382022; CNBC Transcript: Federal Trade Commission Chair Lina Khan Speaks Exclusively with Andrew Ross Sorkin and Kara Swisher Live from Washington, D.C. Today, CNBC (Jan. 19, 2022, 12:30 p.m.), https://www.cnbc.com/2022/01/19/cnbc-transcript-federal-trade-commission-chair-lina-khan-speaks-exclusively-with-andrew-ross-sorkin-and-kara-swisher-live-from-washington-dc-today.html.

[6] *See, e.g.*, Zephyr Teachout, Mega-mergers like AT&T and Time Warner crush American democracy, Guardian (Jun. 13, 2018, 6:00 a.m. EDT), https://www.theguardian.com/commentisfree/2018/jun/13/mega-mergers-att-time-warner-crush-american-democracy.

[7] *See, e.g.*, Tim Wu, Opinion, A Corporate Merger Cost Us Ventilators, N.Y. TIMES, Apr. 12, 2020, at A23.

[8] *See, e.g.*, Sandeep Vaheesan, Two-and-a-Half Cheers for 1960s Merger Policy, Harv. L School Antitrust Blog (Dec. 12, 2019), https://orgs.law.harvard.edu/antitrust/2019/12/12/two-and-a-half-cheers-for-1960s-merger-policy/.

[9] Noah Joshua Phillips, The Repeal of Hart-Scott-Rodino, GLOB. COMPETITION REV. (Oct. 6, 2021), https://globalcompetitionreview.com/gcr-usa/federal-trade-commission/the-repeal-of-hart-scott-rodino.

[10] *See* Jan Rybnicek (@jmrybnicek) (Apr. 22, 2022, 10:25 a.m.), https://twitter.com/jmrybnicek/status/1517509986787672065 (showing that the rate of merger challenges under the Biden Administration is the same as or lower than the rate under the Trump Administration); see also Noah J. Phillips (@FTCPhillips), (Sept. 30, 2021, 3:00 p.m.), https://twitter.com/FTCPhillips/status/1443652046893223938 (showing the dramatic drop in merger enforcement after Biden Administration came into office).

[11] Compare DECHERT LLP, DAMITT Q1 2022: SIGNIFICANT MERGER INVESTIGATIONS FACE STEEPER HURDLES TO SETTLEMENT (Apr. 21, 2022), https://www.dechert.com/knowledge/publication/2022/4/damitt-q1-2022—significant-merger-investigations-face-steeper-h.html (reporting the average duration of significant U.S. antitrust merger investigations as 12.9 months in Q1 2022), with DECHERT LLP, DAMITT Q1 2020: NO COVID-19 IMPACT ON MERGER INVESTIGATIONS . . . YET (Apr. 21, 2020), https://www.dechert.com/knowledge/publication/2020/4/damitt-q1-2020—no-impact-from-covid-19—-yet.html (average duration of 11.1 months in Q1 2020).

[12] Peter Boberg & Andrew Dick, Findings From the Second Request Compliance Burden Survey, THRESHOLD: NEWSLETTER OF THE MERGERS & ACQUISITIONS COMM. (Am. Bar Assoc. Section on Antitrust L.), Summer 2014, at 26, 33, https://media.crai.com/wp-content/uploads/2020/09/16164357/Threshold-Summer-2014-Issue.pdf. Granted, some of the deals in the sample were quite large, but even half the median—$2 million—is a big outlay for a small-to-medium-sized business. And the smaller you are, the harder it is to spend that kind of money.

[13] Letter from Scott Moses, Head of Grocery,

Pharmacy & Rest. Inv. Banking, Solomon Partners, and Scott Sher, Member, Wilson Sonsini Goodrich & Rosati PC, to U.S. Dep't of Justice and Fed. Trade Comm'n 6-22 (Apr. 19, 2022) (on file with author).

[14]*See, e.g.*, Lina M. Khan, Amazon's Antitrust Paradox, 126 YALE L. J. 710, 773-74, 780 (2017); Luke Gannon & Stacy Mitchell, On Pitchfork Economics: How Walmart Gutted Communities, Inst. for Local Self-Reliance (Oct. 28, 2021), https://ilsr.org/monopolies-and-the-policies-that-favor-them-have-gutted-rural-and-urban-communities/.

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[16]Reviving Competition Part 3: Strengthening the Laws to Address Monopoly Power Before the H. Subcomm. on Antitrust, Com., and Admin L., 117th Cong. 1 (Mar. 18, 2021) (prepared statement of Noah Joshua Phillips, Comm'r, Fed. Trade Comm'n), https://www.ftc.gov/system/files/documents/public_statements/1588324/finalformattedpreparedstatementofftccommissionernoahjoshuaphillipsmarch182021hearing.pdf.

[17]Statement of Commissioners Noah Joshua Phillips and Christine S. Wilson Regarding the Commission's Indefinite Suspension of Early Terminations 1 (Feb. 4, 2021), https://www.ftc.gov/system/files/documents/public_statements/1587047/phillipswilsonetstatement.pdf.

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[19]Bruce Japsen, Thermo Fisher To Buy Covid-19 Test Maker Mesa Biotech For $450 Million, FORBES (Jan. 19, 2021, 8:52 a.m.), https://www.forbes.com/sites/brucejapsen/2021/01/19/thermo-fisher-to-buy-covid-19-test-maker-mesa-biotech-for-450-million/?sh=556735535d82; Joe C. Matthew, COVID-19: Thermo Fisher to introduce point-of-care RT-PCR test in India, Business Today, Jun. 15, 2021, 7:34 p.m.), https://www.businesstoday.in/latest/economy-politics/story/covid-19-thermo-fisher-to-introduce-point-of-care-rtpcr-test-in-india-298757-2021-06-15.

[20]Dissenting Statement of Commissioners Christine S. Wilson and Noah Joshua Phillips Regarding the Statement of the Commission on Use of Prior Approval Provisions in Merger Orders 1 (Oct. 29, 2021), https://www.ftc.gov/system/files/documents/public_statements/1598095/wilson_phillips_prior_approval_dissentingstatement102921.pdf.

[21]Statement of the Commission on Use of Prior Approval Provisions in Merger Orders (Oct. 25, 2021), https://www.ftc.gov/system/files/documents/public_statements/1597894/p859900priorapprovalstatement.pdf.

[22]*Id.* at 2 ("This should signal to parties that it is more beneficial to them to abandon an anticompetitive transaction before the Commission staff has to expend significant resources investigating the matter.").

[23]Dissenting Statement of Commissioners Christine S. Wilson and Noah Joshua Phillips, supra note 20, at 4 n. 14.

[24]Decision & Order at 6, Hikma Pharmaceuticals/Custopharm, File No. 221-0001, Docket No. C-4762 (F.T.C. Apr. 18, 2022), https://www.ftc.gov/system/files/ftcgov/pdf/2210002C4762HikmaCustopharmOrder.pdf.

[25]Decision & Order at 19, EnCap/EP Energy, File No. 211-0158, Docket No. C-4760 (F.T.C. Mar. 25, 2022), https://www.ftc.gov/legal-library/browse/cases-proceedings/2110158-encapep-energy-matter.

[26]Decision & Order at 19, Price Chopper/Tops Markets, File No. 211-0002, Docket No. C-4753 (F.T.C. Jan. 24, 2022), https://www.ftc.gov/legal-library/browse/cases-proceedings/211-0002-price-choppertops-markets-matter.

[27]Noah Higgins-Dunn, AstraZeneca closes mega $39B Alexion buyout despite antitrust fears, making a splash in rare diseases, Fierce Pharma (July 21, 2021), https://www.fiercepharma.com/pharma/astrazeneca-closes-mega-39b-alexion-buyout-despite-antitrust-fears-making-a-splash-rare; Charley Grant, Post Covid-19, Don't Forget About Healthcare Stocks, Wall Street Journal (Apr. 19, 2021), https://www.wsj.com/articles/post-covid-19-dont-forget-about-healthcare-stocks-11618830180 ("U.S. regulators gave the green light to drugmaker AstraZeneca's AZN 1.29% planned acquisition of Alexion Pharmaceuticals, which was earlier than investors had expected. Alexion shares shot higher in response.").

[28]CNBC, Merck to buy Acceleron for about $11.5 billion in rare-disease drugs push (Sept. 30, 2021), https://www.cnbc.com/2021/09/30/merck-to-buy-drugmaker-acceleron-for-about-11point5-billion.html ("Merck is buying Acceleron Pharma for about $11.5 billion, broadening its portfolio beyond aging cancer drug Keytruda with potential treatments that could bring in fresh revenue. The deal gives Merck access to Acceleron's rare disease drug candidate, sotatercept, which the company expects to be a multi-billion dollar peak sales opportunity, and comes as Keytruda moves toward the loss of market exclusivity in 2028."); Press Release, Merck & Co., Merck Completes Acquisition of Acceleron Pharma Inc. (Nov. 22, 2021), https://www.merck.com/news/merck-completes-acquisition-of-acceleron-pharma-inc/.

[29]Kurt Wagner, Meta Closes $1 Billion Kustomer Deal After Regulatory Review, Bloomberg (Feb. 15, 2022, 4:30 p.m.), https://www.bloomberg.com/news/articles/2022-02-15/meta-closes-1-billion-kustomer-deal-after-regulatory-review ("What followed was a lengthy review process, showing that Meta can still complete big acquisitions, just not quickly. The company passed an FTC review and a separate approval by antitrust authorities in the U.K.").

[30]I take no position on whether any of these deals warranted action by the antitrust agencies. I only note them to illustrate the gulf between the Progressives' strong words and their subsequent deeds.

[31]Dissenting Statement of Commissioners Christine S. Wilson and Noah Joshua Phillips, supra note 20, at 6.

[32]See PREMERGER NOTIFICATION OFF., FED. TRADE COMM'N, INTRODUCTORY GUIDE I: WHAT IS THE PREMERGER NOTIFICATION PROGRAM? 1 (Mar. 2009), https://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide1.pdf.

[33]Holly Vedova, Dir., Bureau of Competition, Adjusting merger review to deal with the surge in merger filings, FED. TRADE COMM'N COMPETITION MATTERS BLOG (Aug. 3, 2021), https://www.ftc.gov/enforcement/competition-matters/2021/08/adjusting-merger-review-deal-surge-merger-filings.

[34]Michael J. de la Merced, Deal-making took a hit in the first quarter of 2022, New York Times (Apr. 15, 2022, 2:15 p.m.), https://www.nytimes.com/live/2022/04/01/business/economy-news-inflation-russia#deal-making-took-a-hit-in-the-first-quarter-of-2022.

FROM THE EDITOR

M&A at Mid-Year

So far, 2022 has embraced its potential for disruption. With global equity valuations on a roller-coaster ride over the past three months, and inflation at 40-year highs, the favorable market conditions that fueled M&A volume from late 2020 through 2021 may well be over. Even the low-rate environment of the past decade could at last be ending—the Federal Reserve is expected to keep raising rates throughout the year in an attempt to reduce inflationary pressures. Predictions of a possible recession are now common among market analysts.

In spring 2022, the M&A market posted declines in volume (for example, a 14% drop month-to-month in April) yet it also experienced substantial increases in deal value. So while U.S. strategic deals fell in number by 18% in April, they rose by 45% in terms of total deal value. This split between volume and value was even more pronounced overseas, as sponsor deals increased in value by over 100% in April.

Sector bright spots include transportation, real estate and tech, where, in late May, one of the largest tech deals in M&A history was announced: chipmaker Broadcom agreeing to acquire VMware for $69 billion in cash and stock. The deal will face review by the FTC or the DOJ, the Committee on Foreign Investment in the United States, and various international regulatory agencies.

Among the most prominent question marks is the future health of special purpose acquisition companies. While U.S. SPAC acquisitions rose in April by 108% in total deal value, this was still down 88% from the highs of December 2021. Ticketing platform SeatGeek and media outlet Forbes Global Media Holdings both recently terminated proposed SPACs, in what appears to be a reaction to the challenges of taking companies public in a rocky time for equities.

There's also the specter of greater SPAC regulations down the road. Sen. Elizabeth Warren said in May that she would introduce a bill to codify the SEC's recently proposed rules on SPACs and add some more: for example, the bill would reportedly extend the SPAC sponsor's lockup period and would increase liabilities for both sponsors and underwriters. As Axios noted, however, "Warren hasn't had success in getting her Wall Street bills taken up by the Senate, let alone passed into law."

The M&A Lawyer will be back in early August. We hope that all of our readers have a wonderful early summer.

Chris O'Leary

Managing Editor

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