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THE FORCE AWAKENS: A RESURGENCE OF M&A IN 2015

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After close to a decade of anemic M&A, 2015 was "the big year" that dealmakers have been expecting for the last several years. Significant deals took place across a wide range of sectors and geographies. Dealmaking in health care and life sciences continued to be very active, but we also saw a lot of deals in consumer and retail (Kraft/Heinz, AB InBev/SABMiller), media (Cablevision/Altice, Charter/Time Warner) and chemicals (Dow/DuPont, Cytec/Solvay), to name a few industries. Many of the deals were huge. Before the ball dropped in Times Square, we saw more than 50 deals that exceeded $10 billion.

Notably, almost all of 2015's big deals involved only strategic buyers. Industrial acquirors, rather than financial sponsors, led the surge in M&A activity. With acquisition leverage still essentially capped at six times EBITDA, sponsors are finding it hard to compete with the frothy synergy-driven pricing offered by strategic bidders. Some strategic buyers are also borrowing sponsor strategies by levering up their deals or financing them with equity offerings. In fact, 2015 saw an increasing number of in-bound acquisitions by European buyers financed with rights offerings.

Even amidst this strong M&A market, there were signs of choppiness. The Dow plunged in September and the IPO markets have been slow to gather steam, with very few successful IPOs in the fourth quarter. We hate to say it, but the current exuberant pace of M&A deals may not be sustainable unless the capital markets can continue to deliver new, up and coming companies into the mix of potential buyers and targets. Meanwhile, the Fed's decision to raise interest rates will also surely have an impact on the M&A environment as well.

Best of Enemies: Activism Developments

Activism was somewhat old news in 2015 because activism has largely matured into being the "new normal." The level of engagement between issuers, activists and institutional investors has risen to dizzying heights, with all the attendant professionalization of

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the field that one would expect in the form of investor relations advisors of various stripes. Hiring shareholder engagement professionals is even more necessary given the dispersion of decision-making from ISS to a large swathe of in-house governance professionals. The largest institutions now have resources to perform a lot of independent analytics, relying less on ISS and other intermediaries to guide their voting decisions. Pension funds are also doing more direct investing, channeling fewer investments through hedge funds and PE funds and pulling back from having to pay management fees and carry to third-party money managers.

Of course, there were a few exciting moments on the activism front in 2015, like when DuPont defeated Nelson Peltz in a hard-fought proxy battle. But DuPont's victory was bittersweet in a sense, since it was followed in a matter of months by the resignation of DuPont's CEO and, a few months later, by an agreement to sell the whole company to Dow. More recently, Carl Icahn's pledge to top any counteroffer from Bridgestone to acquire Pep Boys, up to $1 billion, set a floor on the price of the company, and set the stage for a dramatic and very public end to the bidding war for Pep Boys.

Setting aside the excitement around Pep Boys and DuPont, many companies have already adapted to the activist playbook and are even defensively initiating internal discussions about issues like capital allocation strategies and board refreshment before an activist appears. For that reason, some short-term activists may be finding it hard to identify "easy" targets for leveraged recap or M&A strategies. Instead, more activists may be finding themselves actually governing operations over the longer term. We anticipate that more patient operators like Starboard Value will continue to rise to the top of the heap in the activist landscape. Perhaps this trend will help to quell the academic debate about the public policy implications of short-termism in activist investing.

Spotlight: Pressure on Private Equity

Private equity funds continue to feel the heat on a number of fronts. They have been subjected to enforcement actions related to charging back monitoring fees and broken deal costs to their limited partners. There have been a number of changes adopted, and even more proposed, to limit the upside for fund managers in the form of carried interest. More strikingly in the pure M&A context, we see very few large leveraged buy-outs of public companies these days. No doubt the economics of those deals simply are not that attractive at the moment due to leverage limits, among other things, but the omnipresent specter of club deal litigation and "entire fairness" review certainly acts as an additional deterrent.

Inside Out: Proxy Access Developments

It is no surprise that 2015 proved to be the year of proxy access proposals. The SEC made clear early in the year that it would take a hands-off approach when it comes to proxy access proposals. This approach is allowing proxy access to flourish through private action after the SEC's proposed proxy access rule, Rule 14a-11, failed to get lift-off. Specifically, the SEC initially indicated that it was reviewing issuers' efforts to exclude proxy access proposals on the basis that they conflict with management proposals. In a follow-up, the SEC confirmed that issuers can only exclude a shareholder proposal on the basis that it conflicts with a management proposal if shareholders could not reasonably vote on both proposals. In practice, when applied to proxy access, for example, there are very few, if any, proxy access proposals that could ever be excluded on the basis that they are conflicting.

Since issuers cannot readily exclude proxy access proposals, the New York State Comptroller and regular proponents like James McRitchie and John Chevedden, among others, have started sending proposals to issuers of all different sizes and industries. Those issuers are now wrestling with whether to adopt their own competing proposal before they mail their proxy statement, to take two alternative proposals to a vote or just to take the shareholder proposal to a vote.

Of particular relevance to M&A, most issuers who implement their own competing proposals appear to be adopting bylaws that do not allow proxy access nominations if the issuer is also simultaneously the subject of a proxy contest or short-slate contest with an activist or hostile acquiror. Accordingly, while the move towards proxy access will undoubtedly have an impact on corporate governance over the longer term, we expect the impact will be relatively slow and incremental and will not immediately accelerate change-in-control dynamics.

Trainwreck: The Regulatory Environment for M&A

Regulatory approvals continued to be a sticking point for many large transactions, as evidenced by the government blocking the Staples/Office Depot deal and the GE/Electrolux deal. In a sense, the blockage of announced deals is a worst-case scenario for M&A practitioners that tests all of their plans to deal with the unpredictable. If the transaction agreements work as they should, the parties can walk away and move on to other things without a protracted dispute. Because the recent large transactions that got blocked ended with a fizzle, with the agreements working as expected, the market absorbed the news relatively quickly and the parties were able to move on with life. Many deals never rise to that level, however, and simply collapse under the weight of antitrust or other regulatory complexity. Rarely an issue in private equity buy-outs, antitrust approvals can be the death of many large strategic combinations. The uncertainty these approvals can generate will probably only get worse in 2016 since it is an election year in the U.S., and to some degree this may quell the current M&A fervor amongst strategics.

Appropriate Behavior: Developments in Delaware Law

Delaware gave a little and took a little this year, so to speak. On the one hand, it became very clear that exclusive forum bylaws would be enforceable in Delaware so that companies could avoid the expense of multi-forum shareholder litigation. On the other hand, however, Delaware has also effectively scuttled the ability to get an intergalactic release of "any and all claims" in exchange for a disclosure-only settlement, leaving buyers with a question mark as to whether a plaintiff could have a successful damages suit post-closing. The effective chilling of disclosure-only settlements, coupled with the fact that Delaware also bolstered companies' ability to fend off efforts to enjoin M&A deals if the shareholder vote was fully informed, is likely to result in even more lengthy proxy statements. At some point, perhaps the courts will have occasion to consider whether 200-page-long disclosure documents are of value to anybody other than the vendors who print and mail them.

Happily for buyers, Delaware has tamped down a little bit on appraisal arbitrage in two respects. First, Delaware amended its appraisal legislation to allow companies to pay the undisputed portion of appraisal claims (the merger consideration amount) up front so that Delaware's statutory interest only applies to the disputed portion of the claim. Second, in a couple of recent cases, the Chancery Court has found that the appraised value is actually the same or less than the merger consideration amount, reinforcing that seeking appraisal is not always a win-win proposition.

Joy: What to Expect in 2016

We think that while M&A activity will inevitably slow down a little in 2016, we will continue to see a steady stream of high profile, public company deals. Specifically, we predict there will be more M&A activity involving tech companies, especially as more of the recent "unicorns" try to cash in on their billion-dollar valuations. We also expect there will be continued activity among pharmaceutical companies. Although regulators have started to shine a brighter spotlight on drug pricing and inversions, there are still a lot of assets in the pharma sector that are poised to trade at high valuations. The big question in our minds is whether we will see any more historic Fortune 100 American corporations go the way of Kraft and DuPont in a widening trend of consolidation and restructuring.