Bringing an end to gamesmanship

Time to restore integrity in business transactions

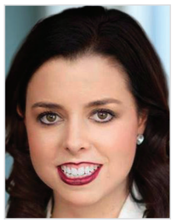
By Jayne E. Juvan and Christopher J. Hewitt

Times of crisis bring out either the good in people or the bad in people.

Multiple times during the Panic of 1907, J.P. Morgan was called upon to help avert disaster. In one particularly noteworthy episode, Morgan summoned the presidents of the largest New York City banks to raise $25 million in 10 minutes to save the New York Stock Exchange. Other than pledging what they could afford on a ledger with their bank's name, none of this was documented.

Roll forward to the COVID-19 pandemic, and it seems very unlikely that this would happen today. Rather — whether it involves governance, commercial contracts or M&A transactions — a common theme we have seen emerge is parties trying to sidestep their fiduciary duties or contractual commitments. Perhaps the poster child for this mentality was Elon Musk's attempt to submarine his Twitter acquisition. While ultimately unsuccessful, others have had better luck — one dated example is the way Ray Kroc pushed the McDonald brothers out of their eponymous business during his own time of personal crisis. (If you're not aware of Kroc's tactics, see *The Founder* (2016)).

Whatever the motivating factor — doing a bad deal, an uncontrolled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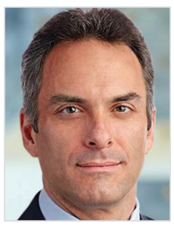
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change in circumstances, using perceived leverage or general civil unrest that seems to absolve a lack of integrity — we have noticed an unfortunate rise in gamesmanship in business transactions of all types. Even more unfortunate has been the lack of supervision, or outright complacency or participation, by boards of directors in allowing this to happen.

Commercial transactions

Until very recently, rarely were we asked to look at a company's basic commercial contracts other than in diligence. Now, we are routinely called in to help our clients defend against attempts to terminate agreements early without cause, reset prices or slow pay (or refuse to pay) legitimate invoices.

To be fair, we also have seen some constructive, business-oriented executives advance solutions in good faith. These executives understand that good decision-making leads to long-term growth.

M&A transactions

One area in M&A transactions where there is rampant gamesmanship is the working capital true-up. Instead of making sure the target business has the right level of working capital so that it can operate without the infusion of outside capital, too many view this as an opportunity to renegotiate purchase price. Similarly, we see some parties interpreting other components of purchase price either to renegotiate price or as a tactic to gain other contractual concessions on unrelated post-closing matters.

We also have seen a rise in unsubstantiated indemnity claims. Until recently, we rarely saw indemnification claims because parties tended to let immaterial breaches go. Nowadays, there is too much of a concerted effort to find any conceivable indemnity claim before the survival period for the representations expires.

Tone at the top

Too often, we see that some boards of directors are themselves pushing the boundaries. We have witnessed directors completely disregard the rules governing their conduct and who brazenly proceed as if the rules do not apply to them.

When operating at their best, directors are self-regulating. Working collectively, they help one another stay in compliance, placing the interests of the organization above their own personal interests. They encourage one another to be good stewards of the organization by knowing and following the rules, coming prepared to meetings and engaging in meaningful debate and discussion. Those who operate in good faith, desiring to demonstrate the utmost integrity, keep the fiduciary duties of care and loyalty at the center of everything they do in their official capacities.

It takes tremendous time, effort and good decision-making for an organization to reach its highest potential. While organizations may be able to sustain themselves for a short period of time under poor leadership, that luck always runs out. That's why it is critical to take the utmost care in vetting directors for a track record of demonstrated integrity and to engage in ongoing training and education.

Conclusion

In 1923, following turbulence in the financial markets stemming from World War I, the London Stock Exchange received its Coat of Arms from the College of Arms prominently displaying the motto "dictum meum pactum," which translated from Latin to English means "my word is my bond." It is well-known that, at its core, the phrase means that you can believe me when I say that I'm going to do something. Fear not, you can trust me to perform as promised.

Maybe it is asking too much from many of today's market participants to act with the altruism demonstrated by business leaders during the Panic of 1907. And it's probably naïve to think people can act without the rigor of a contract guiding their actions. But, hopefully, it's not asking too much to have them honor their commitments. And hopefully it is also not asking too much for boards of directors to set an appropriate tone at the top for these matters.

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Stalwart industries expected to outperform M&A market in 2023

By Ted Motheral

As we leap into a new year, many M&A professionals believe 2023 will be an uncertain market due to interest rate increases and continuing recession concerns. However, there are certain industries that are poised to outperform the market in the coming year. Based upon research and trends, those industries are financial services and health care and pharmaceuticals. In addition, there will be a substantial advantage to private equity and institutional buyers who do not heavily rely on debt financing (and rely on the "dry powder" in equity capital) available to them to take advantage of buying opportunities in these industries.

Financial services (namely wealth management, registered investment advisers and independent broker dealers) has seen a surge in roll-up acquisitions and minority private equity investments in the past few years. Although market volatility has seen a decrease in assets under management for a lot of the sell-side targets in the industry, the opportunity to invest in or acquire sophisticated financial advisory firms (and the historical return on investment over the past few years) remains incredibly attractive to institutional and private equity buyers, as more of these buyers are entering the space. Couple this with the fact that the majority of this industry is in the baby boomer generation and looking for a sound exit or succession plan, and you have the perfect recipe for continued growth (of volume and


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deal size) in the M&A market.

With a recession looming and inflation still very much in the picture, experts always point to those industries that are "recession proof." Health care and pharmaceuticals always seem to fall into that category. The demand for these industries is always constant, especially with the older generation. Experts believe revenues will not see a material change as long as demand holds. Therefore, these M&A market industries will remain constant or even outperform other industries that will more than likely see a substantial drop in deal volume in 2023.

Lastly, outside of industries to watch for, the buyer market will be interesting to watch as well, as those institutional and private equity buyers that usually rely on a debt-to-equity mix for their purchases may look to solely put their equity capital to work to avoid the increase in interest rates. If interest rates continue to rise, then this will put those buyers who have the capital to deploy at a distinct advantage in the market.

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