strate that the Delaware courts are willing, as a legal matter, in the right circumstances, to view the mere size of the holdings of a controlling stockholder as putting that stockholder and its representatives on the subject company's board in a conflict situation. At a minimum, the inability to get rid of such a claim at the motion to dismiss stage means that the litigation will be substantially more time-consuming to defend and more expensive to settle.

These decisions do not mean that all sale transactions involving a public portfolio company will be subject to an entire fairness review, or that a special committee must always be used in such cases to limit liability risks. Particularly in the case where the large stockholder has no immediate need to sell and the public market is sufficiently liquid to provide a viable exit mechanism in the ordinary course, a court would have to go well beyond these recent holdings to impose liability based merely on the size of the controlling stockholder's interest. On the other hand, where a private equity fund stockholder is near or past the end of the fund's life, or a sponsor needs an exit to support its pending fund-raising initiatives, or the public market does not provide a realistic exit route for the large stockholder's investment (but does for other stockholders), the controlling stockholder and the company's board need to take the potential conflict into account. In these circumstances, private equity firms may well wish to consider using the types of procedural protections—such as a special committee and potentially minority stockholder approval—that have been developed in the context of going private transactions to limit litigation risk. Even if the controlling stockholder is confident of being able to satisfy the strict standard of entire fairness—which may well be the case assuming the company is adequately shopped, all stockholders receive the same consideration, and there is no reason to believe the time of sale to be particularly inopportune—the benefit of limiting the litigation risk inherent in a duty of loyalty challenge may well outweigh the cost of giving up control over the sales process.

NOTES
1. Del. Ch., Sept. 30, 2011.
2. Del. Ch., April 11, 2012.
3. Del. Ch., Sept. 29, 2005.

Trends in International M&A in 2012: A Mid-Year Review

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As we move towards the end of the summer, we take stock of the international M&A environment and trends that we have experienced through the first half of 2012 and set out our expectations for the second half of the year. Whilst the global economic downturn and Eurozone sovereign debt issues undoubtedly continue to have a significant effect on M&A activity, there are some signs for optimism for the latter half of 2012, particularly with respect to in-demand sectors and territories. In this article, we examine the M&A drivers and fundamentals that are in place as well as the headwinds that are countering them.

Drivers

Despite the relative slowdown in M&A activity generally, it is clear that several of the key fundamentals for M&A activity are in place. For example, across the U.S., Europe and Asia there are many companies with excess cash on their balance sheets, which needs to be put to work, particularly in this era of historic interest rate lows. In addition, prospects for organic growth are relatively limited, given the wider economic backdrop, and there remains an appetite for companies to consider acquisitions to achieve growth targets and strategic objectives. Similarly, there also remains a significant amount of cash, or "dry powder," that is yet to be deployed by private equity firms, who have their own investors' expectations to meet.

There is also a level of opportunism within certain segments of the market. The continued challenges presented by the wider economic outlook have led to a re-evaluation of focus for certain companies and, in turn, have caused some assets to come to market, sometimes at a relative discount. This has led to the disposal of non-core assets by some, and, in certain cases, a general withdrawal from, or reduction in exposure to, certain of the more challenged economies within Europe. Many participants, particularly within the private equity sector, are setting themselves up to take advantage of these opportunities as and when they arise. The background economic conditions have also led to some owners looking for a strategic acquisition or partnership to ensure the continued viability, scale or prospects for their business.

In addition, regulatory changes being imposed in the financial sector, in particular, have also led financial institutions to seek to deleverage their balance sheet and dispose of non-core assets or businesses. These include disposals as a result of the impending Basel III capital requirements and, in the U.S., the implementation of the new regulatory standards under the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Volcker Rule (which prohibits or limits proprietary trading and hedge fund and private equity fund sponsorship by banks). These changes have led, for example, to several banks seeking to dispose of their asset or wealth management divisions, brokerage operations and servicing businesses.

Headwinds

Overall, it is clear that many of the fundamentals needed to create a healthy M&A environment are currently present. However, despite the fundamentals for activity being in place as described above, conditions globally remain challenging and there are still significant headwinds prevailing against a continued resurgence of M&A activity.

Confidence Is Key

One of the key issues mitigating against M&A activity generally is a profound lack of confidence. The continued uncertainties throughout the Eurozone, the changing political and regulatory landscapes in many key jurisdictions and the current global economic outlook, including a general slowdown in key growth territories like China, have manifested to produce a relatively uncertain and unstable environment and backdrop to the M&A arena.

The Eurozone crisis has undoubtedly had a limiting effect on M&A activity both within Europe and elsewhere. Despite the efforts of the various European politicians and policy makers and the ultimate outcome of the Greek elections in June this year, uncertainty remains in relation to the future of the peripheral member states and fears of a break-up, exit or sovereign default persist. In addition, the general downward effect that the Eurozone issues are having on growth prospects both in Europe and elsewhere, coupled with the anticipated effects of the broad ranging austerity measures, have also had a direct impact on the expected future performance of targets.

In addition, there have been and will continue to be, other uncertainties driven by the political environment in certain key territories. For example, within Europe the holding of the French elections in April and the Greek elections in May and June this year each caused uncertainty as to the stance that each member state would take as regards Europe depending upon which way the election results fell. In the U.S. much will also turn on the outcome of the forthcoming elections in November. On a related note, the continued instability in the Middle East is also having a detrimental effect on the M&A landscape, particularly in relation to deals emanating from or otherwise related to that jurisdiction.

All of the above means that potential buyers are facing the challenges of predicting with sufficient certainty how a potential target will perform in an uncertain environment. Whilst not insurmountable by any means, this has led to a greater degree of caution being exercised by management going into deals and to a recalibration of due diligence focus to fully access and understand these country and/or currency risks.

Other Challenges

There are other headwinds that also need to be to be navigated. For example, interest rates remain at a historic all time low and acquisition financing is relatively cheap, so in theory this should have a positive effect on the M&A market. However, for a variety of reasons, acquisition finance remains generally only available for high credit borrowers in respect of targets with particularly strong cashflows. In addition, whilst the high yield debt market and equity markets remain an option for some issuers in the U.S., the opportunities to raise finance to fund acquisitions in Europe remain particularly challenging. As a result, the trend has been for deals to be predominantly financed from existing cash resources and/ or stock, which we expect to continue through the latter half of the year.

Separately, both shareholders and regulators appear increasingly willing to bear their teeth in response to acquisitions. On the shareholder front there has been an increased tendency for shareholders generally to be more willing and vocal in their stewardship of investee companies, led by the introduction of the Stewardship Code in the U.K. in 2010 and similar initiatives in other jurisdictions, and this has translated into the M&A context as well. For example, earlier this year Xstrata's shareholder vote in relation to its announced $65 billion merger with Glencore was postponed until September given shareholder concerns over executive pay.

On the regulatory front, the international merger regime is becoming increasingly complex, for example, with more and more territories introducing or amending their merger control regimes, and regulators remain willing to block deals which breach any of the applicable thresholds. For example, in February this year we saw the European anti-trust authorities block the proposed $7.4 billion merger of NYSE Euronext and Deutsche Boerse. This has made an early anti-trust analysis and assessment of deals across the affected territories particularly important and has also led to an increased importance for up-front discussions and agreement between the parties as to where the merger control risk should lie on any given deal.

Hotspots

Although headwinds remain, there are still certain sectors and territories that have performed well and are expected to remain favorable for activity throughout the latter half of the year.

As expected, the energy sector remains particularly buoyant in terms of volume, driven principally by the ongoing international competition for natural resource assets. The technology sector also remains active with strategic acquisitions, driven by the ongoing competition between the key market participants in this field.

Whilst the life sciences sector has not performed quite as favourably as last year, with activity down slightly, there has been some significant activity. Generally, this is expected to continue given the inherent challenges facing the life sciences sector generally, including impending patent expirations, declining pipelines and sales, decreased healthcare spend, regulatory reform and increased regulation.

In addition, and as noted above, we also expect activity to continue in the financial services sector as institutions continue to re-focus and dispose of non-core assets in light of the regulatory and other challenges faced by them.

In terms of territories, the emerging markets continue to be a source of attention for those looking to expand into high growth areas. For example, Latin America saw a rise in activity in the first half of the year, as did Africa. There continues to be an interest from international companies looking to expand into these territories and this is a trend we expect to continue going forward. As a result, there will continue to be a focus on certain of the key legal issues arising when considering deals in such regions, including robust assessments of anti-corruption risk in light of, for example, the Foreign Corrupt Practices Act in the U.S. and the Bribery Act in the U.K., as well as other issues such as tax, merger control, exchange control, foreign ownership restrictions, regulatory impediments and so on.

Conclusion

Overall, it is true that the downward trend in M&A activity experienced in the latter half of 2011 continued throughout the first half of 2012, principally due to the challenges and headwinds that continue to be present, as discussed above. However, there remains room for cautious optimism. In terms of figures, Q2 2012 was more vibrant than Q1, suggesting that the sluggish start at the beginning of the year can be overcome.

In any event, one thing is clear and that is that the approach to M&A needs to continue to adapt to reflect today's challenges and economic backdrop. As suggested above, it requires recognition by both buyers and sellers alike as to the environment in which they are operating. Deals can get done, but they require an early understanding and clear agreement as between the parties as to the apportionment of risk on any particular deal.