

LAWDRAGON

De-SPACs, Activist Investors and The Energy Transition



Photo by Nick Coleman

M&A TRENDS WITH CRAVATH'S BOB TOWNSEND (R) AND GEORGE SCHOEN

By Alison Preece

Cravath's global M&A practice is the gold standard: widely respected and well known, the group has a deep bench of talent, and every single lawyer on the team is excellent at what they do.

Based on the complexity and sheer number of high-quality transactions done year over year, it may surprise some people to learn that the group is pretty slim: fewer than two dozen partners.

Cravath's famous rotation system means associates spend time in several different partner groups. This means all the newer M&A partners have typically already worked with most of the senior ones. "It helps people have a common mindset about how to approach things,"

says George Schoen, co-head of Cravath's Global M&A group. "Our first-year M&A partners are fully ready to run deals."

Schoen joined Robert Townsend as co-head of the elite group in 2021, a role Townsend has been in since 2017. They made a structural shift in the group when Schoen stepped in to reflect the shape of the market, as they previously demarcated between international and domestic deals, which is no longer necessary given the amount of crossover in so many transactions.

The shift is typical of how the group operates: They are business-minded and pragmatic, working nimbly across industries in all aspects of deal work, able to adjust themselves on a dime so they're always aligned with the market they serve.

Thanks to the tight-knit culture and high caliber of legal talent, Townsend and Schoen are able to have a hands-off management style and focus on their practices – they simply hire and cultivate great minds, then let them get to work.

Lawdragon: What are the defining characteristics of Cravath's global M&A group? What makes it work?

Bob Townsend: We pride ourselves on being very commercial and delivering excellent and practical legal advice. To be a good M&A lawyer, you have to not only know the law, but you have to understand the situation and your client's objectives, and provide practical solutions to issues. It's not always in the client's best interest to fight over everything. There are a lot of situations where the client wants to maintain a good relationship with the party on the other side and/or wants to get the deal done quickly. You need to discern the most meaningful points, focus on those and not get hung up in a negotiation war. All the partners in the group have been at Cravath since they started, so we're all trained in that same mindset. It's the driving feature of our practice and permeates the entire firm.

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LD: How would you describe your management style?

George Schoen: It's interesting, the phrase "management style" implies a level of active management, which really isn't how either of us approaches the role. We make sure we're giving the younger partners all the right opportunities they need to develop as a Cravath M&A partner. We're fortunate that we have such great colleagues and M&A partners that everyone is generally very busy and really dedicating themselves to their practice.

So our focus is more from a wide angle. We look at what the M&A group as a whole is doing in a given year, what sectors we're active in, the types of deals happening, and then see if there are adjustments to make.

LD: Let's talk SPACs. They were so hot for a while there. Why have they cooled off?

GS: SPACs were initially attractive to participants for a number of reasons, including because the de-SPAC transaction represented a faster route to being a public company than a traditional IPO. And those are falling out of favor for a few reasons. To execute a de-SPAC transaction, it typically requires fresh money from new investors, usually institutional investors, to either support the valuation or backstop redemptions from the original SPAC investors. During the SPAC boom of 2020 and 2021, that fresh money was readily available because people were excited about these acquisitions and the ability to invest in a growth company at an early stage.

Starting about a year ago, that institutional money started to dry up. Investors were looking at the relative success, or lack thereof, of de-SPAC transactions in terms of where those companies were trading, and they started to get more critical. We're seeing a lot of SPACs liquidating because they can't execute that de-SPAC transaction within the time horizon required.

BT: So, now you have no way of knowing how many of the original investors are going to redeem. Redemption percentages have skyrocketed as SPAC performance has been poor. Then you're basically left with having to go find new financing for the deal through a pipe and put together a package. In many cases, that winds up being at a lower valuation level than the SPAC had been talking to you about to begin with, so you wind up taking a haircut in order to put together enough money to be able to do a deal.

Suddenly it's a much less efficient way of doing a merger or buying a company, because the initial money just isn't staying in. We've seen SPAC situations where the redemption level is 90 percent, and then you've lost all the efficiencies of having money already in hand. You might as well just get committed financing from a sponsor in the regular way.

GS: On the heels of that, there's a lot of litigation around de-SPAC transactions currently working its way through the courts. The first significant decision, coming out of Delaware early this year, was pretty negative on de-SPACs, regarding the conflicts between the SPAC sponsor and the rest of the shareholders. It made a lot of people in the SPAC space, including financial advisors, take notice.

There are also a whole host of new SEC regulations that, if enacted, are going to make it even more challenging for SPACs to execute the de-SPAC transaction.

BT: I've represented a couple of sellers who were running auction processes that had both SPAC and non-SPAC buyers. In both cases, the seller decided not to go with the SPAC entity, even though they were nominally offering a higher value, because of these uncertainties.

LD: How about decarbonization and the energy transition movement – what impact is that having in the energy industry in terms of dealmaking?

GS: It really depends on the company and their perspective. Some are taking it very seriously, because they see the energy transition movement as a real business threat to what their current

operations and business profile are, so they want to change and adapt in order to survive. Others are staying the course.

We've seen companies do a spin-off to separate operations into two businesses, one that's carbon-heavy and one that's not. We've seen divestitures, or some companies just organically transitioning their business mix away from carbon-heavy businesses.

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We're also seeing activists use decarbonization as one of their elements of a campaign against companies. First you had Engine No. 1 winning board seats at Exxon, as well as Dan Loeb advocating at Shell that they split up and separate their heavy carbon business from the carbon-light business. It's definitely on a lot of people's minds.

LD: What impact has the rise of shareholder activism had on boardrooms and companies in the last 15 years?

GS: It's really grown as a strategy. Not only the aggregate assets under management that are dedicated to that strategy, but also just the number of activist funds that are out there. Even though if you look at activism as an asset class over the past two or three years, maybe if you disregard what's happened in the market this year, it hasn't necessarily done as well as the S&P 500 over that time horizon. Still, I don't see it going away as an asset class anytime soon.

Fifteen, 20 years ago, you could count on two hands how many activist investors were out there. At this point, most public company board members have had experience with activism. Sometimes through campaigns, other times conversations that weren't made public. But the company took into account the views of the activist, whether was it factored into a decision to undertake an M&A transaction or to change their capital allocation planning or, potentially, to make a management change.

It's become the normal framework of boards these days. They want to talk about activism, including with outside advisors. Companies want to understand what's going on in the marketplace and make sure everyone is prepared in the event that an activist makes an outreach.

BT: Yes, most public company boards are much more actively evaluating their strategies. They're considering various alternatives, and how an activist would look at them. They look at typical things that an activist would encourage and are proactively doing the work themselves – evaluating whether there are business lines that ought to be disposed of, evaluating whether there's a more strategic transaction. Successful companies always did that work, of course, but it's become much more widespread and more detailed.

It's a good rationale. Aside from a strong stock price, which is probably your best defense against an activist, it's helpful to be able to demonstrate that the board is its own activist. It

doesn't need a shareholder representative on the board to take the steps to evaluate what's in the shareholder's best interest, because they're already taking those steps, whether it's externally-driven or about board refreshment or board diversity.

LD: What other trends are you seeing in the M&A market?

GS: Antitrust and financing challenges have certainly gotten stronger in the past six to 12 months, at least. Last year, there was a very robust debt financing market here in the states, and more generally globally, so it was very easy to get deals that required financing done. Now things are much choppier.

In particular, when you're dealing with a private equity buyer where they're going to leverage the acquisition pretty heavily, those deals are not going off as smoothly as they were 12 months ago. We've seen some instances where a private equity buyer has even said, "Look, I'd love to do the deal at this price, but can we wait three months or six months? I need the financing markets to come back."

Then with the change in administration in D.C., it's definitely a new attitude in terms of antitrust enforcement. It has changed the way a lot of people are looking at M&A, especially where it's more of a consolidation play in a specific industry.

LD: What initially attracted you both to M&A law? What do you enjoy about it?

BT: I always tell people that I would never be an M&A lawyer if I hadn't come to Cravath. When I first started, I didn't really know a lot about different corporate practices. I did banking for my summer and thought I'd want to be there. But I chose Cravath because it gave you the opportunity to really learn the different practice areas in depth by rotating in your time as an associate. So, I felt I could make the most educated decision.

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When I first started doing M&A, as a fourth- or fifth-year associate, we got hired by Dreamworks when it was first being formed. I was the lead associate and so I spent six to nine months, mostly out in California, helping them raise their initial equity and debt financing. That was completely unique to anything I'd ever done before, both because it involved Steven Spielberg and this exciting new movie studio, but also, we were creating the company from scratch. It was basically like a joint venture negotiation. That sold me on the idea of M&A. I like the variety, the intersection of the business strategy elements, and the evolving legal framework. I thought to myself, "This would be a fun thing to do for the rest of my career."

What I like best about the practice is the people. This is a people business. I love practicing at Cravath because of people like George and the rest of the people in our department and across the firm. We have incredible, talented people in tax and benefits, in IP, environment and antitrust, the whole gamut. You can't be successful unless you have incredibly talented people.

Then, our clients. You get the opportunity to really help people change their companies and do important things for them and you can really contribute a lot of value. It's always nice when they're grateful and appreciative.

GS: Like Bob, I didn't do M&A at Cravath until my third rotation, so I was a mid-level associate. I actually did my first public company M&A deal with Bob as the partner, and I just thought it was really cool. I was a senior associate on it, integrated into the real principal-to-principal discussions. We were talking to boards and management teams about why they're doing this deal, from a business perspective. Understanding that rationale, then we translated that into, how do we make the approach to the counterparty? What are the legal considerations? I was hooked.

I also appreciate the diversity of the situations that we get involved in. It's not just pure buy-side, sell-side transactions at Cravath. We cover joint ventures, we cover activism. Deal work can involve antitrust or takeover defense or analyzing a shareholder base to see what approach might make the most sense. We do a lot of cross-border work, collaborating with lawyers around the world on transactions, understanding how the different rules work in different jurisdictions which you then factor into your US approach on deals. It's just fascinating, and a lot of fun.

LD: What advice do you have for young associates who are just starting out in their M&A law careers?

GS: When you first start out as a junior M&A associate, you're obviously not going to be the one running the negotiations or probably even being primarily responsible for the main acquisition or other agreement. You will probably have more direct responsibility for other aspects of the transaction. But it's very important not to feel siloed into what's specifically assigned to you and to try to get a more holistic understanding of the deal. That's how you learn and grow. It also positions you to make sure that what you're specifically tasked with works well with the rest of the deal, so you can be proactive if you see the deal is heading in a certain direction.

At Cravath, we very much operate on the principle of including the whole deal team in discussions with the client and negotiations with the other side. Everyone gets a holistic understanding of the transaction. When you have that kind of mentality, it also positions you well to take on more and more responsibility with those other elements as you get more experience.

BT: My biggest piece of advice is, don't be afraid to ask questions. Ask questions. I think a lot of young lawyers are nervous about asking questions of partners or even senior associates. But everyone would much rather you ask questions and make sure you understand what you're working on, rather than you feeling like you have to figure it out on your own.

Also, you're going to make mistakes. That's fine, that's how you develop. Just try not to make them more than once. Learn from your mistakes, and go make new ones.

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