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Expert Q&A on Health Care Mergers and Acquisitions

AbbVie Inc.'s proposed $63 billion acquisition of Allergan plc is one of the largest health care mergers announced in 2019. Practical Law asked *Igor Kirman* of *Wachtell, Lipton, Rosen & Katz* to discuss his role as Allergan's legal counsel and to offer guidance on related trends in health care M&A and other large public M&A transactions.

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Igor is a partner in the firm's Corporate Department, where he focuses primarily on mergers and acquisitions, activism and takeover defense, corporate governance, and general corporate matters. He has advised public and private companies, as well as private equity funds, in connection with mergers and acquisitions, divestitures, leveraged buyouts, joint ventures, and cross-border deals.

You recently worked on the $63 billion AbbVie/Allergan deal. What can you tell us about the proxy fight Allergan had prior to the AbbVie deal?

It was a non-traditional proxy fight, short on proxy and long on fight. Appaloosa Management, a hedge fund run by Carolina Panthers' owner David Tepper, submitted a shareholder proposal under Rule 14a-8 under the Securities Exchange Act of 1934 to immediately separate the board chair and CEO roles at Allergan.

Appaloosa made two significant choices:

- It submitted its shareholder proposal as a Rule 14a-8 shareholder proposal on the company's proxy statement, rather than filing its own proxy materials and soliciting votes in opposition to management, which lowered the cost substantially for Appaloosa.
- It insisted on an immediate separation of the board chair and CEO roles, instead of the more commonly seen

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approach, which allows the board flexibility on the timing of implementation (typically, implementation occurs at the next CEO transition).

We won by engaging with shareholders and showing the bad bargain being advocated. Allergan had been focused on board refreshment for some time and had a strong lead independent director with enhanced responsibilities. It also adopted a policy to separate the board chair and CEO roles at the next CEO transition. From a governance perspective, which is what the Appaloosa proposal seemed to be on the surface, Allergan had adopted best practices and more. We argued successfully that separating the roles immediately would not add value, and would undermine the company's leadership at a time when they needed to execute on their strategy.

Search Proxy Contests for more on proxy fights.

Search How to Handle Shareholder Proposals, Deadlines for Rule 14a-8 Shareholder Proposals: Chart, and Rule 14a-8 Shareholder Proposal Process Flowchart for more on Rule 14a-8 shareholder proposals.

We were also able to persuade both Glass Lewis & Co. and Institutional Shareholder Services Inc. (ISS), two of the most influential proxy advisory firms, to vote against Appaloosa's proposal, which seemed like its own mini battle. Ultimately, we won more than 61% of the vote.

Search Developing Relationships with Proxy Advisory Firms for more on proxy advisory firms.

Was this an example of activism leading to M&A? What is the state of activism in the health care sector?

The AbbVie/Allergan deal came about for other reasons. There was no activist pressure on Allergan to do a deal. Having said that, I am very glad Allergan won the proxy fight with Appaloosa, to avoid doubts over Allergan's strategic choices and negotiating leverage. It proved the thesis of our proxy defense, that the company was better off with a strong leadership team, rather than a weakened one.

More generally, health care sector activism currently is robust, and has been just outside the top five sectors targeted by activists in the past several years. M&A has been the dominant theme of all activism in recent years, with approximately one-third of all activist campaigns focused on M&A of some kind. The three main sub-types of M&A activism are:

- **Company sales.** The most common M&A activist theme involves a push for the sale of the company. An example is Elliot Management's 2018 campaign at athenahealth, Inc., which led to its sale to Elliot Management and Veritas Capital (for more information, search Veritas Capital/Evergreen Coast Capital and athenahealth, Inc. Merger in What's Market on Practical Law).
- **Divestitures or spin-offs.** This involves a push for a company's divestiture of non-core assets or a break-up of the company (for more information, search Spin-Offs: Overview, Carve-Out Transactions, and Carve-Out Transactions: Key Seller Considerations on Practical Law). Examples include Starboard Value LP's activism at Magellan Health Inc. and at Perrigo Company plc.
- **Deal activism.** This involves opposition to an announced M&A transaction, either on the target side to improve deal terms or on the buyer side to oppose the deal. Examples include Starboard's opposition to the Bristol-Myers Squibb/Celgene Corp. deal earlier in 2019, and Carl Icahn's opposition to the Cigna Corp./Express Scripts deal (for more information, search Bristol-Myers Squibb Company and Celgene Corporation Merger and Cigna Corporation and Express Scripts Holding Company Merger in What's Market on Practical Law). Both of these activist campaigns failed.

In addition to M&A activism, we have seen activist campaigns focused on board representation (which is sometimes a first step in a stealth M&A campaign), cost cutting, and capital allocation. In fact, my first interaction with Allergan, together with my partners Andrew Brownstein and Elina Tetelbaum, who also worked on the AbbVie/Allergan deal, was related to board seat activism. In 2011, Carl Icahn took a stake in Forest Laboratories, Inc., an Allergan predecessor company, and fought a proxy fight seeking four seats on its board. We defeated him, and he came back each of the next two years. Although M&A was not a disclosed theme, Icahn had been making a series of bets on consolidation in the space. It turned out to be a winning bet when the company decided to sell itself (without a push from him) to Actavis plc in 2014 (for more information, search Actavis plc and Forest Laboratories, Inc. Merger in What's Market on Practical Law).

With the amount of capital raised by activist funds, despite some sub-par performance by many of them, I expect that health care activism will continue to be robust in the years to come regardless of market valuation.

What was unusual about the AbbVie/Allergan deal?

In recent years, when we have combined a US company and an Irish company, we have become accustomed to seeing the Irish company come out on top (the so-called inversion transactions). However, the AbbVie/Allergan deal contemplates the reverse outcome. This meant good recent precedents in the health care space were lacking, and so we ended up working with several models from which we took different pieces.

In addition, because Allergan is an Irish company, and was the target here, we were subject to the Irish Takeover Rules. We therefore had to comply with both US and Irish rules at all times.

What were some of the key Irish provisions that came into play?

A transaction with an Irish target company involves very sensitive public disclosure requirements, which require close monitoring of the market and disclosure in the event of anomalous price movements or credible rumors. The Irish Takeover Panel is very strict, and the time for compliance is measured in minutes, not hours. Right at the beginning we established a complicated leak protocol with pages of "what if" decision trees, including prepared

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statements and all-hours contact information. Because we were dealing with the Irish Takeover Panel, the odds were high that we may be forced to release disclosures during Irish trading hours, which begin at night in New York.

The Irish rules added some structure and constraints to the agreements. Ireland is committed to deal certainty, so financing is required to be "certain funds," and buyers face large hurdles to terminate deals, especially based on gray areas or judgment. On the other hand, Ireland is also very protective of shareholder interests, and a target company cannot pay the type of break-up fees we usually see for Delaware target companies, such as 3% to 4% of the equity value. Instead, the maximum fee for an Irish target company is typically an expense reimbursement of up to 1% of the equity value, which is documented in a separate expense reimbursement agreement. The ratio of pages of the agreement (typically around 15) to size of the fee is quite high.

Other key Irish provisions included rules relating to public statements, the shareholder circular, and the shareholder vote approval requirement, which is 75% in value of the target company's shares and a majority in number of the shareholders of each class of the target company's shares.

Search Public Mergers and Acquisitions in Ireland: Market Analysis Overview for more on Irish public mergers.

Search Public Mergers: Overview, Public Mergers Disclosure: Overview, and Break-Up or Termination Fees for more on US public mergers, including applicable laws, disclosure considerations, and break-up fees.

What is driving health care M&A to record levels?

Health care M&A is spurred by both opportunities and challenges. Global biopharma M&A volumes, in particular, have already reached a record pace in 2019, with megamergers, such as the Bristol-Myers Squibb/Celgene and AbbVie/Allergan deals, leading the way. Key trends that are contributing to this increased activity include:

- **Innovation drive.** The drive to innovation is a significant catalyst. Pharmaceutical companies continue to look to biotech companies to deal with expiring patents and as a source of innovation. A recent estimate suggests that the proportion of revenues coming from innovation sourced outside of Big Pharma has grown from about 25% in 2001 to about 50% in 2016 (see McKinsey & Co., What's Behind the Pharmaceutical Sector's M&A Push (Oct. 2018), available at *mckinsey.com*). Especially hot areas are oncology, gene therapy, and rare diseases.
- **Efficiencies, scaling, and consolidation.** Companies are keen to increase efficiency and build scale, and are preparing for pricing pressure as many actors in the health care value chain also consolidate. For example, hospitals have been consolidating, and acquiring medical practices, to build scale, increase efficiency, and anticipate the arrival of value-based care models. In the early 1990s, half of the hospitals in the US were stand-alone, and currently less than one-third are not affiliated with a hospital system. At the same time, those dealing with hospital groups (for example, insurance companies and pharmaceutical companies) have also bulked up to better compete in the realigned health care ecosystem.
- **Vertical integration.** Convergence, or vertical integration, is a big theme we are seeing. After the US antitrust authorities blocked the Anthem/Cigna and Aetna/Humana horizontal mergers in the health insurance space in 2017 (for more information, search DC Circuit Rejects Anthem-Cigna Antitrust Appeal and District Court Blocks Aetna-Humana Merger on Practical Law), it did not take long for the industry, and some of the same companies, to respond with vertical moves up and down the supply chain, seeking to provide more "one-stop shopping" for consumers. In 2018, CVS Health Corp. combined with Aetna Inc. and Cigna Corp. bought Express Scripts Holding Co., the nation's largest pharmacy benefit manager (PBM), in two megamergers that illustrate this evolution (for more information, search CVS Health Corporation and Aetna Inc. Merger and Cigna Corporation and Express Scripts Holding Company Merger in What's Market on Practical Law). Humana Inc.'s 2018 acquisition of Kindred Healthcare, Inc., a home health care company, using an innovative transaction structure with two private equity sponsors, and United Health Group's 2019 acquisition of DaVita Medical Group, are two examples of how insurers are seeking to integrate health care providers in response to industry pressures (for more information, search TPG Capital/Welsh, Carson, Anderson & Stowe/Humana Inc. and Kindred Healthcare, Inc. Merger and Collaborative Care Holdings, LLC Acquisition of Equity Interests of DaVita Medical Holdings, LLC in What's Market on Practical Law).
- **Increased M&A activity by private equity funds.** There has been a steady increase in private equity M&A activity in health care, and the amount of "dry powder" that private equity funds currently have suggests this will continue. As health care companies reposition portfolios and sell non-core assets, private equity buyers have stepped in to pick up assets with proven cash flow generation. Private equity buyers bring significant operational and turnaround expertise, and have also partnered with strategic buyers to take advantage of their respective strengths. The Kindred deal noted above involved TPG Capital and Welsh Carson teaming with Humana in an innovative structure that split Kindred into two pieces, with one business owned by the sponsors and the other business owned 60% by the sponsors and 40% by Humana (with a path to full ownership by Humana through puts and calls). Such partnerships can add a lot of value, but are more complex to structure and could present misalignment of interests due to different investment horizons.
- **Portfolio restructuring.** Divestitures have been a source of M&A in recent years. Many companies are repositioning themselves to focus on chosen areas, and to free up resources for innovation in certain niches. Pfizer Inc., Merck & Co., and Eli Lilly and Co., among others, have either announced or executed on major portfolio restructuring plans to focus attention on core areas. Prior to its AbbVie deal, Allergan had been executing on a strategic portfolio transformation, moving from having a revenue mix of 60% branded and 40%

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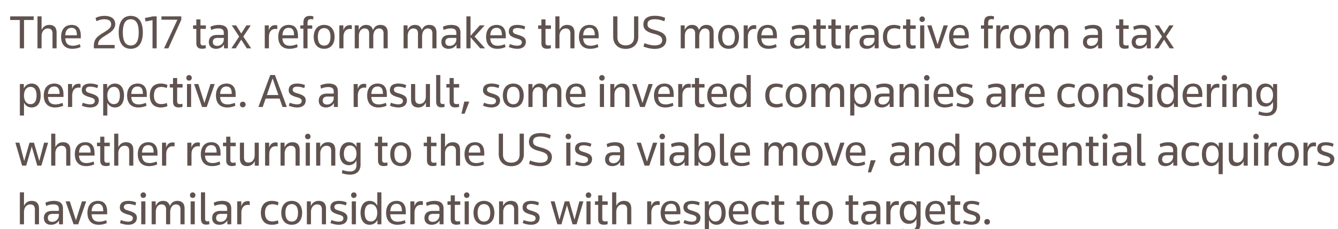

The 2017 tax reform makes the US more attractive from a tax perspective. As a result, some inverted companies are considering whether returning to the US is a viable move, and potential acquirors have similar considerations with respect to targets.

generics in 2014 to having 87% of 2018 revenue come from promoted or other brands with ongoing exclusivity.

How has the 2017 tax reform affected health care M&A?

Tax reform has had many effects, across the various sub-sectors of health care. By moving to a territorial taxation regime that exempts future foreign earnings, even if repatriated, and by allowing US companies to repatriate accumulated overseas earnings (estimated to be $2.6 trillion at the time of the law's passage and subject to a one-time repatriation tax of 15.5% for cash holdings and 8% for other assets), the law has provided an M&A war chest for many multinationals in the health care space. While some of the money remains overseas and other uses have been found for the repatriated money (for example, capital expenditures, debt reduction, and return of capital), some of the repatriated money has been used to fuel M&A activity. In part, this has contributed to the sharp rebound in health care M&A in 2018 and 2019, compared to the low volumes of 2016 and 2017.

We are also seeing the predicted realignment of portfolios in the form of divestitures. Companies that hesitated to pay tax on big gains from divestitures now have relief as a result of the lower tax rate. In a simplified sense, the move from a 35% to a 21% headline tax rate provides for a 40% lower tax bill on certain divestitures. That can be the margin between doing a deal and not doing it, especially where the divested business lacks enough scale for a spin-off transaction. It also makes divestitures more competitive with tax-free spin-offs, and we have seen companies announce a separation intent and then pursue both a spin-off and a sale on a parallel path.

Search Tax Reform: Implications for Multinational Businesses, M&A, and Private Equity for more on tax reform.

Search Spin-Offs: Overview and Memorandum to Board: Issues When Considering a Spin-Off for more on spin-off transactions.

Have you seen a reversal of inversion transactions?

The tax law has accelerated the trend away from inversions and may signal the inversion of the inversion trend. Over the past several decades, over 60 US public companies, including health care companies such as Allergan, Johnson Controls International plc, Medtronic plc, Mylan N.V., and Perrigo, have moved their jurisdiction of incorporation to non-US locations, such as Ireland, the Netherlands, and the UK. Generally, these jurisdictions provided lower corporate rates and made other favorable tax strategies possible.

However, inversions generated political opposition, and in 2016, during the pendency of the largest inversion transaction ever, the Pfizer/Allergan combination (for more information, search Allergan plc and Pfizer Inc. Merger in What's Market on Practical Law), the US Department of the Treasury passed regulations that limited many of the economic benefits of inversion transactions. The Pfizer/Allergan deal, and some others then pending, were terminated and inversion transactions reduced to a trickle. (For more information, search IRS Issues Anti-Inversion, Earnings-Stripping Guidance on Practical Law.)

The 2017 tax reform makes the US more attractive from a tax perspective, most prominently by lowering the corporate federal income tax rate from 35% to 21% and further targeting some of the tax planning strategies previously available. As a result, some inverted companies are considering whether returning to the US is a viable move, and potential acquirors have similar considerations with respect to targets.

In recent months, we have seen two large transactions (the AbbVie/Allergan and Pfizer/Mylan deals) that will result in inverted companies coming back to the US. The Mylan move, in particular, has a personal resonance for me. In 2015, I was defending Perrigo, itself an inverted Irish company, against Mylan, when Teva launched a hostile bid for Mylan. Mylan swiftly defeated Teva's bid by using some potent anti-takeover devices available under Dutch law, including the colorfully named *stichting* (a foundation that could be issued voting control of up to 50% of a corporation's shares). We were frustrated to have our hostile bidder lose its own pursuer, especially because as an Irish company, Perrigo did not have anything resembling this in its arsenal. That made the defense harder, but it also made it more fun and the victory sweeter in the end. Plus, I got quite the education in Irish, Dutch, and Israeli law.

Search Expert Q&A on Perrigo's Successful Defense of Mylan's Hostile Takeover Attempt for more on how Perrigo thwarted Mylan's hostile takeover attempt.

How significant is the threat of price controls on the biopharma space?

It is a storm on the horizon, for sure. The US has been the innovation hub for the world, and the source of close to 60% of

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new pharmaceutical drugs worldwide in recent years. Our large pharmaceutical companies spend close to 20% of their revenue on research and development (R&D), which is more than any other industry spends on R&D. That number would grow if you consider the purchase of R&D through biotech acquisitions.

However, the cost of drug discovery is steep, with an average drug costing $2.6 billion in R&D (see Joseph A. DiMasi, Henry G. Grabowski, & Ronald W. Hansen, Innovation in the Pharmaceutical Industry: New Estimates of R&D Costs, J. of Health Econ. (May 2016)) and taking decades to produce, which has led to prices in the US being higher than in other developed counties, most of which impose price controls. Politicians have periodically attacked biopharma companies over cost, and in recent years those attacks have escalated.

Hillary Clinton's "price gouging" tweet on the presidential campaign trail in 2015 reduced the valuation of biotech companies by $15 billion the very next day. President Trump jumped on the same bandwagon and made drug pricing an issue in the 2016 campaign and ever since, rolling out various plans, including seeking to make drug pricing transparent, allowing imports from Canada, and proposing to allow some prices to be set based on prices in other countries. PBMs are being attacked for "stealing" discounts that should be passed along to patients.

Virtually all current Democratic presidential candidates would like to go even further in the direction of price controls, and some want to nationalize health care. Congress has not been far behind, and biopharma companies took notice when Mylan was brought before Congress several times in 2016 to explain its EpiPen pricing. The presidential campaign season has already commenced, so unfortunately political pressures will continue to weigh on pharmaceutical company valuations and M&A opportunities.

What are other important regulatory or litigation developments?

The Food and Drug Administration (FDA) is showing a commitment to regulatory innovation, including shortening approval timelines and allowing a record number of generic approvals (2018 broke the record previously set in 2017). Of course, not everyone is cheering every change. With more generics flooding the market, prices continue to fall and generics makers have seen steep declines in market value. That makes for a tough M&A environment in this sub-segment.

Opioid litigation is a serious threat to some segments of biopharma. We have seen several settlements, and one verdict. Purdue Pharma L.P., the company with the largest expected exposure, has filed for bankruptcy in connection with pursuing a massive settlement framework. Meanwhile, investors and potential acquirors are trying to extrapolate or predict the exposure for other companies. The number of potential plaintiffs has multiplied because not only states, but also cities and counties, are jumping into the fray. The litigations can drag on for years. Uncertainty is never good for the deal business, but we and our clients will try to find creative solutions to mitigate the risk.

Are you optimistic about the future of health care M&A, despite these challenges?

There are serious challenges ahead to various sectors within health care, and of course any individual company may be on the short end of the massive disruption and political pressures that are emerging. However, our market system has also shown how nimble companies are in anticipating and responding to these challenges, and seeking to take advantage of emerging opportunities. Among many other trends, we are seeing:

- Experimentation with value-based models.
- The use of data analytics and digital health initiatives.
- The rise of precision and personal medicine.
- A focus on patient (or consumer) driven health care, sometimes known as "consumerism."

Apple Inc. is working with a startup to add diagnostic data to smartphones, Google LLC's parent company, Alphabet Inc., is using artificial intelligence to improve everything from differential diagnosis to drug discovery, and Amazon.com, Inc. bought an online pharmacy called PillPack LLC to potentially disrupt the medicine delivery business. The so-called "Amazonification" of health care is putting consumer expectations center stage.

In the meantime, with aging baby boomers and heightened expectations of health care among younger generations, the demand will exist for growth and change. As a consumer, as a citizen, and as an attorney, I am excited for the road ahead.

As an attorney, does most of the value you add come from health care expertise or M&A expertise?

I am an M&A attorney, very broadly defined. I work on public and private deals of every type you can think of, as well as governance, activism, and hostile situations. I love the health care space and have been fortunate enough to spend a fair amount of my time in recent years working on health care M&A transactions. I view it as a privilege to also work on M&A transactions in many other sectors. Currently, I have several deals in the health care sector, and am also working with clients on transactions in the energy, media, and industrials sectors.

Taking a broad perspective in life, whether in law or other pursuits, helps to develop good judgment, a balanced approach to crises, and a willingness to be creative and blaze new trails. On any given matter, my best insight can come from two decades of experience, or it can come from page 82 of a book I read the previous weekend. Knowing what other attorneys did on the last five similar deals is only a small part of the needed skillset and not the highest value part. Having the judgment to know when and how to use those five deals, and when not to, is harder, but more valuable. We M&A attorneys are lucky to be able to range both widely and deeply in expertise. But it does make for long hours.

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