M&A Report

2018

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2018 M&A Report – What's Inside

2 Market Review and Outlook

5 Takeover Defenses: An Update

8 Sale Process Considerations Under the "Entire Fairness" Standard

10 Combating the Dramatic Rise in Federal M&A Lawsuits

11 Law Firm Rankings

12 Selected WilmerHale M&A Transactions

14 Preparing for Your Cross-Border Deal

16 Foreign Investment in US Companies: The CFIUS Factor

18 FCPA Considerations in M&A Transactions

19 A Comparison of Deal Terms in Public and Private Acquisitions

22 Trends in VC-Backed Company M&A Deal Terms

24 *Initial Public Offerings: A Practical Guide to Going Public*

REVIEW

Despite generally favorable macroeconomic conditions, high levels of cash among strategic acquirers and low interest rates, the number of reported M&A transactions and deal value worldwide both declined for the second consecutive year in 2017.

The number of reported M&A transactions worldwide dropped by 10%, from 59,544 deals in 2016 to 53,854 in 2017. Global M&A deal value decreased 9%, from $3.59 trillion to $3.26 trillion.

The average deal size in 2017 was $60.6 million, up slightly from the $60.4 million average for 2016, but trailing the $69.4 million figure for 2015. The number of worldwide billion-dollar transactions decreased 3%, from 520 in 2016 to 503 in 2017, while aggregate global billion-dollar deal value declined 8%, from $2.10 trillion to $1.9 trillion.

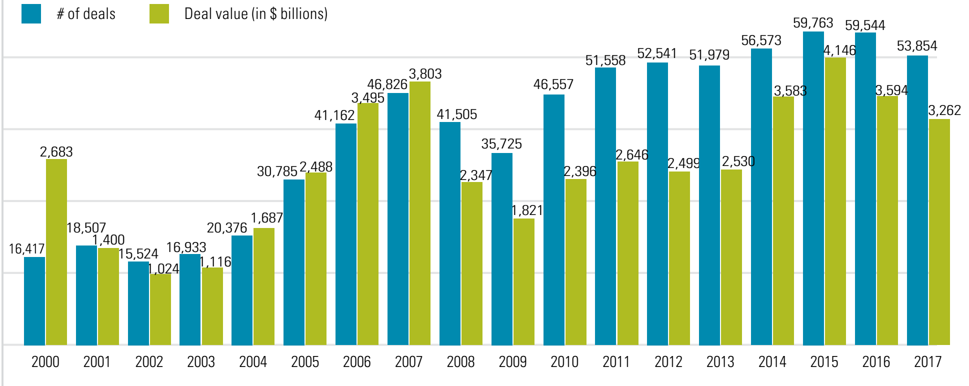
Geographic Results

Deal volume and aggregate deal value decreased across all geographic regions in 2017:

— *United States*: Deal volume in the United States declined 13%, from 21,666 transactions in 2016 to 18,957 in 2017. US deal value decreased by 15%, from $2.24 trillion to $1.91 trillion. Average deal size dipped by 3%, from $103.6 million in 2016 to $100.9 million in 2017—still the third-highest average deal size in the United States since 2007, trailing only 2016 and the $106.3 million average for 2015. The number of billion-dollar transactions involving US companies declined by 5%, from 333 in 2016 to 315 in 2017, while the total value of these transactions decreased 17%, from $1.63 trillion to $1.36 trillion.

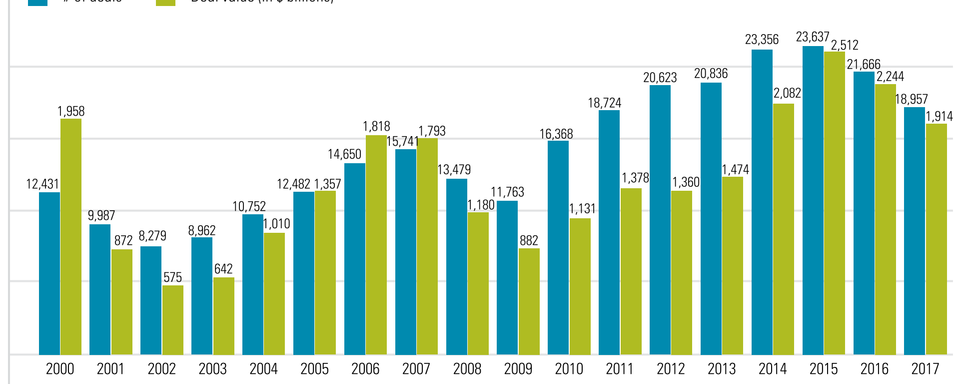
— *Europe*: The number of transactions in Europe declined 7%, from 22,305 in 2016 to 20,721 in 2017. Total deal value decreased 15%, from $1.41 trillion to $1.19 trillion. Average deal size declined for the third consecutive year, dropping 9% to $57.4 million in 2017, from $63.0 million in 2016. The number of billion-dollar transactions involving European companies increased from 195 in 2016 to 199 in 2017 but the total value of these transactions decreased by 17%, from $926.5 billion to $771.9 billion.

— *Asia-Pacific*: The Asia-Pacific region saw a 9% decline in deal volume, from 16,926 transactions in 2016 to 15,330 in 2017. Total deal value fell 16%, from $1.25 trillion to $1.05 trillion, and average deal size dropped 7%, from $73.8 million to $68.5 million. Billion-dollar transactions decreased by 15%, from 180 to 153, and their total value declined by 20%, from $644.8 billion to $513.6 billion.



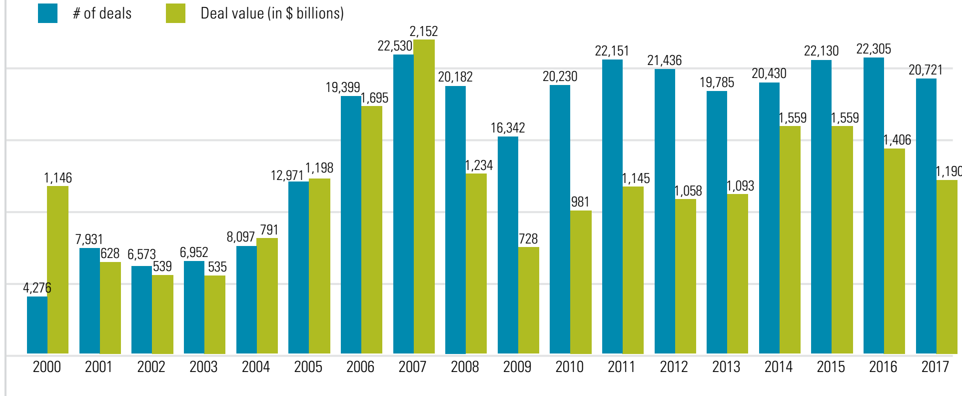
Source: S&P Global Market Intelligence

US M&A Activity – 2000 to 2017



Source: S&P Global Market Intelligence

European M&A Activity – 2000 to 2017



Source: S&P Global Market Intelligence

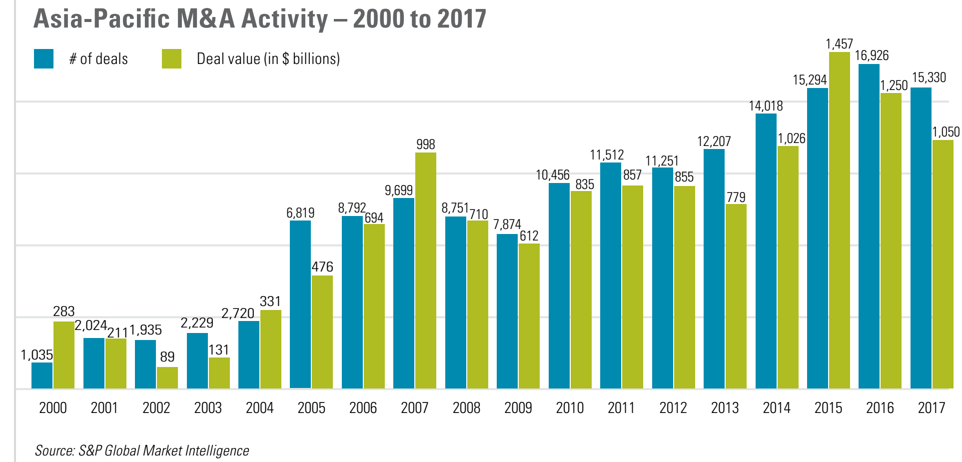
Sector Results

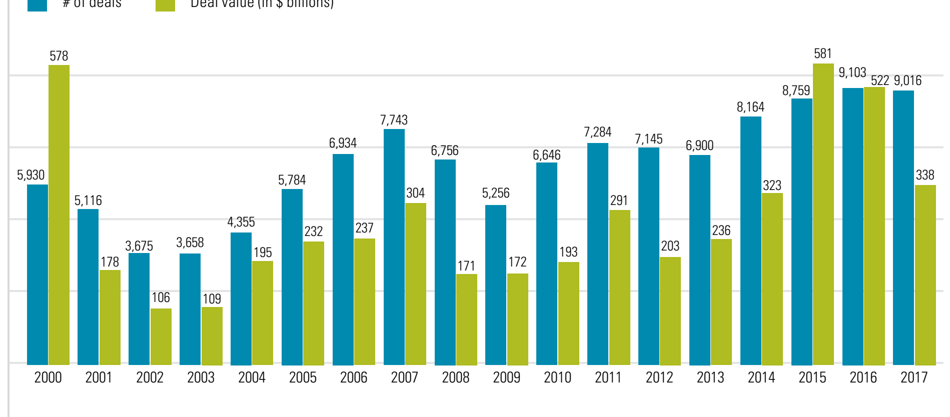
Global M&A deal volume varied across sectors in 2017. Deal volume declined modestly in all principal industry sectors, other than financial services, while deal value decreased more sharply across all sectors. M&A results in the United States largely paralleled global trends in 2017.

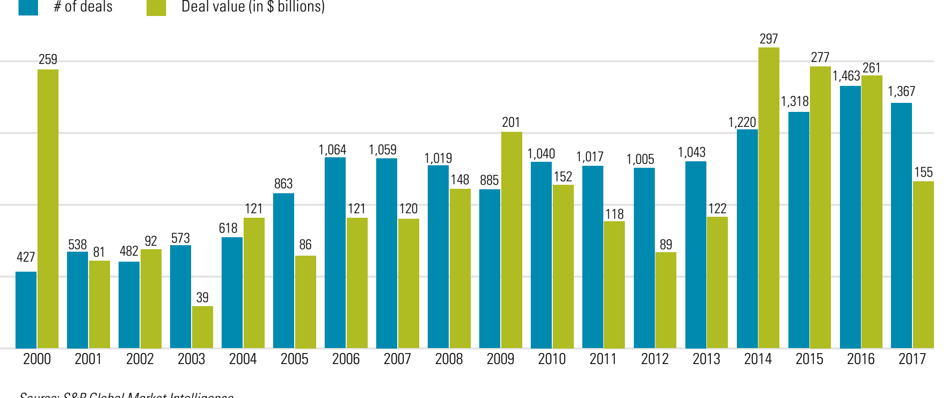
— *Technology*: Global transaction volume in the technology sector dipped from 9,103 deals in 2016 to 9,016 deals in 2017, while global deal value contracted—for the second consecutive year—by 35%, from $522.1 billion to $338.4 billion. Average deal size in the technology sector declined 35%, from $57.4 million in 2016 to $37.5 million in 2017. In line with global trends, US technology deal volume inched down from 3,528 in 2016 to 3,502 in 2017, and total deal value dropped by 42%, from $375.4 billion to $217.2 billion, resulting in a 42% decline in average deal size, from $106.4 million to $62.0 million.

— *Life Sciences*: Global transaction volume in the life sciences sector decreased 7%, from 1,463 deals in 2016 to 1,367 deals in 2017, while global deal value dropped for the third consecutive year, falling 41%, from $261.4 billion to $155.0 billion. As a result, average deal size in the life sciences sector decreased 37%, from $178.7 million to $113.4 million. Paralleling global trends, life sciences deal volume in the United States declined by 3%, from 546 to 530, and total deal value fell 47%, from $232.2 billion to $123.0 billion, producing a 45% drop in average deal size, from $425.3 million to $232.1 million.

— *Financial Services*: In financial services—the best-performing industry sector in 2017—global M&A activity increased 3%, from 2,955 deals in 2016 to 3,042 deals in 2017, while global deal value declined by 18%, from $329.1 billion to $271.3 billion. Average deal size in the sector decreased 20%, from $111.4 million to $89.2 million. In the United States, financial services sector deal volume increased 10%, from 1,174 to 1,289, and total deal value declined by 25%, from $204.2 billion to $153.5 billion. As a result, average US deal size in the financial services sector decreased 32%, from $173.9 million to $119.1 million.



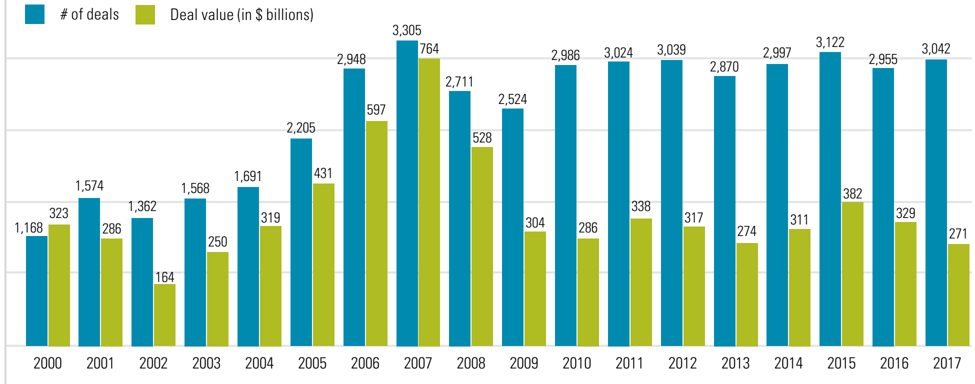




— *Telecommunications*: Global transaction volume in the telecommunications sector declined slightly, from 729 deals in 2016 to 715 deals in 2017. However, global telecommunications deal value decreased by 69%, from $251.0 billion to $78.1 billion, resulting in a 68% decrease in average deal size, from $344.3 million to $109.3 million. US telecommunications deal volume

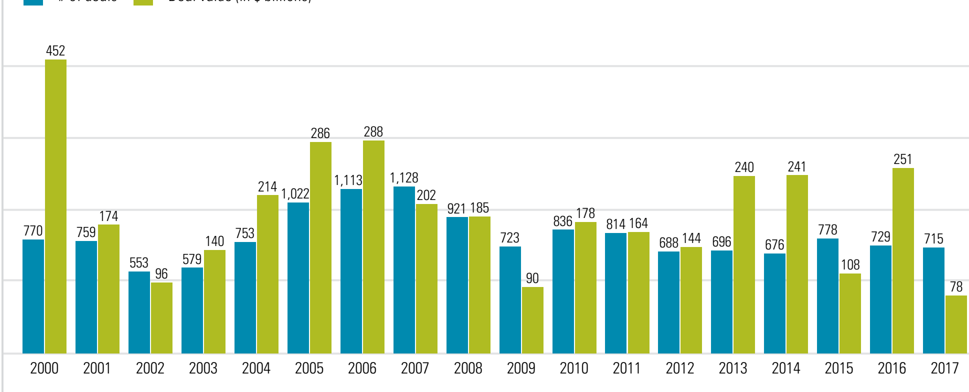
decreased 17%, from 225 to 186, while total deal value plummeted by 81%, from $209.0 billion to $39.6 billion. The average US telecommunications deal size in 2017, at $213.2 million, was 77% below the $928.9 million average deal size in 2016.

— *VC-Backed Companies*: The number of reported acquisitions of US VC-backed companies declined by 2%, from 613 in 2016 to 600 in 2017. The median acquisition price increased by 8%, from $92.4 million in 2016 to $100.0 million in 2017—equaling the record median price of $100.0 million, set in 2000. Although reported proceeds declined by 13%, from $88.0 billion to $76.4 billion, the total for 2017 still represents the fourth-highest annual level, behind the $97.8 billion tally for 2000 (at the height of the dot-com boom), the $86.6 billion in 2014, and the 2016 total. Once all acquisitions are accounted for, 2017 deal activity should top the total for 2016, but 2017 deal value is unlikely to match the figure for 2016.



Source: S&P Global Market Intelligence

Telecommunications M&A Activity – 2000 to 2017



Source: S&P Global Market Intelligence

OUTLOOK

The M&A market remains fundamentally sound despite two consecutive years of decline in global deal volume and value. Heading into 2018, several factors suggest the market may be poised to reverse its recent declines and once again approach the aggregate deal volume and value of 2015 and 2016. Still, headwinds affecting the overall market remain, and individual deals may continue to encounter regulatory challenges.

Deal activity should benefit from the combined effect of economic growth in all major economies; high levels of cash held by both strategic and private equity acquirers (with a boost from the new tax law enacted in late 2017); resilient equity markets; an uptick in inbound M&A activity; and the continued desire of many companies to pursue acquisitions to supplement organic growth.

Other important factors that will affect M&A activity in the coming year include the following:

— *Macroeconomic Conditions*: The US economy grew 2.3% in 2017 but faces some degree of uncertainty as the current cycle of economic expansion is aging. A strengthening global economy coupled with the overhaul of US corporate and individual income tax rates in late 2017 may spur higher growth this year, although increasing interest rates, inflationary pressures and various geopolitical factors could dampen near-term economic growth.

— *Valuations*: Near-record-high stock market valuations—notwithstanding the corrections that occurred in the first quarter of 2018—may discourage buy-side activity by acquirers concerned about overpaying for publicly held targets, while also making some sellers less willing to accept buyer stock as consideration because of perceptions of limited upside potential and significant downside risk. Among privately held targets, prices in some sectors are being driven up by intensifying competition due to the record levels of capital that private equity firms are seeking to deploy.

— *Private Equity Activity*: Buy-side activity may be chilled by the increased cost of debt-financed acquisitions from a combination of rising interest rates and limitations on the deductibility of business interest under the new tax law. On the sell side, private equity firms increased their fundraising for the fifth consecutive year, and are facing pressure to exit investments and return capital to investors.

— *Venture Capital Pipeline*: Many venture-backed companies and their investors prefer the relative ease and certainty of being acquired to the lengthier and more uncertain IPO process. The attractive valuations and solid aftermarket performance of VC-backed IPOs in 2017—which increased in number by 28% from 2016—should prompt additional IPOs in 2018. ■

Set forth below is a summary of common takeover defenses available to public companies—both established public companies and IPO companies—and some of the questions to be considered by a board in evaluating these defenses.

CLASSIFIED BOARDS

Should the entire board stand for re-election at each annual meeting, or should directors serve staggered three-year terms, with only one-third of the board standing for re-election each year?

Supporters of classified, or "staggered," boards believe that classified boards enhance the knowledge, experience and expertise of boards by helping ensure that, at any given time, a majority of the directors will have experience and familiarity with the company's business. These supporters believe classified boards promote continuity and stability, which in turn allow companies to focus on long-term strategic planning, ultimately leading to a better competitive position and maximizing stockholder value. Opponents of classified boards, on the other hand, believe that annual elections increase director accountability to stockholders, which in turn improves director performance, and that classified boards entrench directors and foster insularity.

SUPERMAJORITY VOTING REQUIREMENTS

What stockholder vote should be required to approve mergers or amend the corporate charter or bylaws: a majority or a "supermajority"?

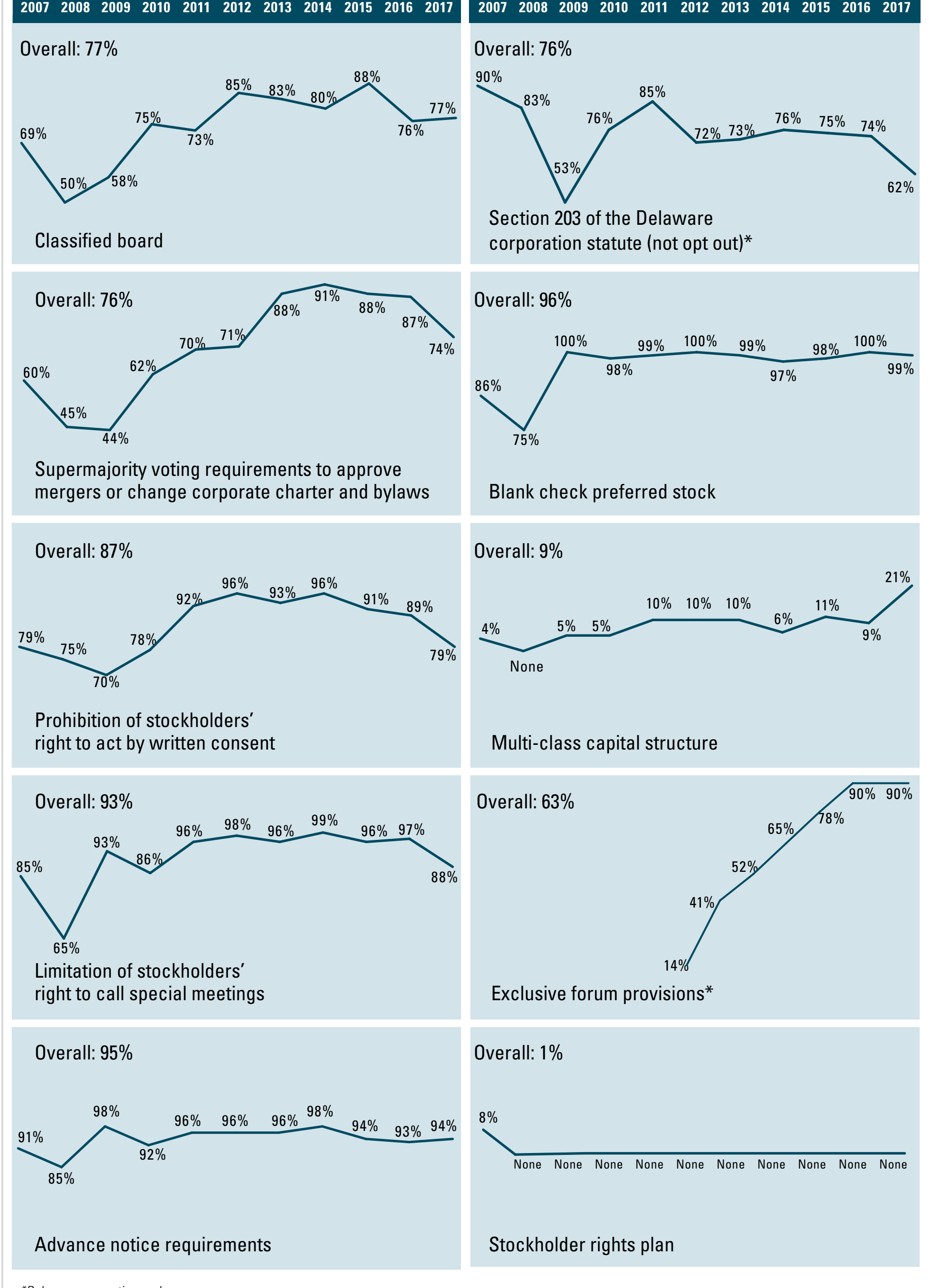
Advocates for supermajority vote requirements claim that these provisions help preserve and maximize the value of the company for all stockholders by ensuring that important corporate actions are taken only when it is the clear will of the stockholders. Opponents, however, believe that majority-vote requirements make the company more accountable to stockholders by making it easier for stockholders to make changes in how the company is governed. Supermajority requirements are also viewed by their detractors as entrenchment provisions used to block initiatives that are supported by holders of a majority of the company's stock but opposed by management and the board. In addition, opponents believe that supermajority requirements—which generally require votes of 60% to 80% of the total number of outstanding shares—can be almost impossible to satisfy because of abstentions, broker non-votes and voter apathy, thereby frustrating the will of stockholders.

PROHIBITION OF STOCKHOLDERS' RIGHT TO ACT BY WRITTEN CONSENT

Should stockholders have the right to act by written consent without holding a stockholders' meeting?

Written consents of stockholders can be an efficient means to obtain stockholder approvals without the need for convening

TRENDS IN TAKEOVER DEFENSES AMONG IPO COMPANIES



*Delaware corporations only
Source: WilmerHale analysis of SEC filings from 2007 to 2017 (2011–2017 only for exclusive forum provisions) for US issuers.

a formal meeting, but can result in a single stockholder or small number of stockholders being able to take action without prior notice or any opportunity for other stockholders to be heard. If stockholders are not permitted to act by written consent, all stockholder action must be taken at a duly called stockholders' meeting for which stockholders have been provided detailed information about the matters to be voted on, and at which there is an opportunity to ask questions about proposed business.

LIMITATION OF STOCKHOLDERS' RIGHT TO CALL SPECIAL MEETINGS

Should stockholders have the right to call special meetings, or should they be required to wait until the next annual meeting of stockholders to present matters for action?

If stockholders have the right to call special meetings of stockholders, one or a few stockholders may be able to call a special meeting, which can result in abrupt changes in board composition, interfere with the board's ability to maximize stockholder value, or result in significant expense and disruption to ongoing corporate focus. A requirement that only the board or specified officers or directors are authorized to call special meetings of stockholders could, however, have the effect of delaying until the next annual meeting actions that are favored by the holders of a majority of the company's stock.

ADVANCE NOTICE REQUIREMENTS

Should stockholders be required to notify the company in advance of director nominations or other matters that the stockholders would like to act upon at a stockholders' meeting?

Advance notice requirements provide that stockholders at a meeting may only consider and act upon director nominations or other proposals that have been specified in the notice of meeting and brought before the meeting by or at the direction of the board, or by a stockholder who has delivered timely written notice to the company. Advance notice requirements afford the board ample time to consider the desirability of stockholder proposals and ensure that they are consistent with the company's objectives and, in the case of director nominations, provide important information about the experience and suitability of board candidates. These provisions could also have the effect of delaying until the next stockholders' meeting actions that are favored by the holders of a majority of the company's stock.

PREVALENCE OF TAKEOVER DEFENSES AMONG IPO COMPANIES AND ESTABLISHED PUBLIC COMPANIES

	IPO COMPANIES	ESTABLISHED PUBLIC COMPANIES	
		S&P 500	RUSSELL 3000
Classified board	77%	10%	42%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	76%	22% to 40%, depending on type of action	18% to 57%, depending on type of action
Prohibition of stockholders' right to act by written consent	87%	70%	74%
Limitation of stockholders' right to call special meetings	93%	36%	51%
Advance notice requirements	95%	97%	91%
Section 203 of the Delaware corporation statute (not opt out)*	76%	94%	82%
Blank check preferred stock	96%	95%	95%
Multi-class capital structure	9%	9%	10%
Exclusive forum provisions*	63%	41%	41%
Stockholder rights plan	1%	2%	4%

**Delaware corporations only*
Source: IPO company data is based on WilmerHale analysis of SEC filings from 2007 to 2017 (2011–2017 only for exclusive forum provisions) for US issuers. Established public company data is from SharkRepellent.net at year-end 2017.

STATE ANTI-TAKEOVER LAWS

Should the company opt out of any state anti-takeover laws to which it is subject, such as Section 203 of the Delaware corporation statute?

Section 203 prevents a public company incorporated in Delaware (where more than 90% of all IPO companies are incorporated) from engaging in a "business combination" with any "interested stockholder" for three years following the time that the person became an interested stockholder, unless, among other exceptions, the interested stockholder attained such status with the approval of the board. A business combination includes, among other things, a merger or consolidation involving the interested stockholder and the sale of more than 10% of the company's assets. In general, an interested stockholder is any stockholder that, together with its affiliates, beneficially owns 15% or more of the company's stock. A public company incorporated in Delaware is automatically subject to Section 203, unless it opts out in its original corporate charter or pursuant to a subsequent charter or bylaw amendment approved by stockholders. Remaining subject to Section 203 helps eliminate the ability of an insurgent to accumulate and/or exercise control without paying a control premium, but could prevent stockholders from accepting an attractive acquisition offer that is opposed by an entrenched board.

BLANK CHECK PREFERRED STOCK

Should the board be authorized to designate the terms of series of preferred stock without obtaining stockholder approval?

When blank check preferred stock is authorized, the board has the right to issue shares of preferred stock in one or more

DIFFERENCES IN ANTI-TAKEOVER PRACTICES AMONG TYPES OF IPO COMPANIES

	ALL IPO COMPANIES	VC-BACKED COMPANIES	PE-BACKED COMPANIES	OTHER IPO COMPANIES
Classified board	77%	89%	80%	48%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	76%	85%	80%	51%
Prohibition of stockholders' right to act by written consent	87%	94%	91%	67%
Limitation of stockholders' right to call special meetings	93%	97%	97%	81%
Advance notice requirements	95%	98%	97%	84%
Section 203 of the Delaware corporation statute (not opt out)*	76%	96%	38%	70%
Blank check preferred stock	96%	98%	99%	91%
Multi-class capital structure	9%	8%	5%	14%
Exclusive forum provisions*	63%	60%	73%	56%
Stockholder rights plan	1%	1.5%	0.5%	1%

*Delaware corporations only
Source: WilmerHale analysis of SEC filings from 2007 to 2017 (2011–2017 only for exclusive forum provisions) for US issuers.

series without stockholder approval under state corporate law (but subject to stock exchange rules), and has the discretion to determine the rights and preferences, including voting rights, dividend rights, conversion rights, redemption privileges and liquidation preferences, of each such series of preferred stock. The availability of blank check preferred stock can eliminate delays associated with a stockholder vote on specific issuances, thereby facilitating financings and strategic alliances. The board's ability, without further stockholder action, to issue preferred stock or rights to purchase preferred stock can also be used as an anti-takeover device.

MULTI-CLASS CAPITAL STRUCTURES

Should the company sell to the public a class of common stock whose voting rights are different from those of the class of common stock owned by the company's founders or management?

While most companies go public with a single class of common stock that provides the same voting and economic rights to every stockholder (a "one share, one vote" model), some companies go public with a multi-class capital structure under which specified pre-IPO stockholders (typically founders) hold shares of common stock that are entitled to multiple votes per share, while the public is issued a separate class of common stock that is entitled to only one vote per share (or no voting rights at all). Use of a multi-class capital structure facilitates the ability of the holders of the high-vote stock to retain voting control over the company and to pursue strategies to maximize long-term stockholder value. Critics believe that a multi-class capital structure entrenches the holders of the high-vote stock, insulating them from takeover attempts and the will of public stockholders, and that the mismatch between voting power and economic interest may also increase the possibility that the holders of the high-vote stock will pursue a riskier business strategy.

EXCLUSIVE FORUM PROVISIONS

Should the company's corporate charter or bylaws provide that the Court of Chancery of the State of Delaware is the exclusive forum in which stockholders may bring state-law claims against the company and its directors?

Since 2010, numerous Delaware corporations have adopted exclusive forum provisions, following judicial and then legislative endorsement of the technique. Exclusive forum provisions typically stipulate that the Court of Chancery of the State of Delaware is the exclusive forum in which internal corporate claims may be brought by stockholders against the company and its directors. Proponents of exclusive forum provisions are motivated by a desire to adjudicate state-law stockholder claims in a single jurisdiction that has a well-developed and predictable body of corporate case law and an experienced judiciary. Opponents argue that these provisions deny aggrieved stockholders the ability to bring litigation in a court or jurisdiction of their choosing.

STOCKHOLDER RIGHTS PLANS

Should the company establish a poison pill?

A stockholder rights plan (often referred to as a "poison pill") is a contractual right that allows all stockholders—other than those who acquire more than a specified percentage of the company's stock—to purchase additional securities of the company at a discounted price if a stockholder accumulates shares of common stock in excess of the specified threshold, thereby significantly diluting that stockholder's economic and voting power. Supporters believe rights plans are an important planning and strategic device because they give the board time to evaluate unsolicited offers and to consider alternatives. Rights plans can also deter a change in control without the payment of a control premium to all stockholders, as well as partial offers and "two-tier" tender offers. Opponents view rights plans, which can generally be adopted by board action at any time and without stockholder approval, as an entrenchment device and believe that rights plans improperly give the board, rather than stockholders, the power to decide whether and on what terms the company is to be sold. When combined with a classified board, rights plans make an unfriendly takeover particularly difficult. ■

Sale Process Considerations Under the "Entire Fairness" Standard

Following the Delaware Supreme Court's 2015 decision in *Kahn v. M&F Worldwide Corp.*, a general consensus has emerged as to the procedural safeguards that can be deployed to avoid "entire fairness" review of a transaction involving controlling stockholders or conflicted directors. Although it is now widely accepted that the "business judgment" standard can be preserved in such a transaction by conditioning its completion on approval by a special committee of disinterested directors and approval by the holders of a majority of all shares held by disinterested stockholders (a so-called "majority of the minority" vote), that approach is not always viable. This is particularly true in M&A transactions involving targets funded by venture capital investors that hold rights in opposition to the requirements for a business judgment standard of review.

In the typical venture capital financing structure, investors are issued preferred stock that entitles them to receive priority in any distribution of the company's assets, including the proceeds of a "liquidation event" (generally defined to include a merger or a sale of all or substantially all the company's assets). Large investors are also generally entitled to representation on the board of directors, and may have veto rights over significant transactions, often including a company sale. Venture capitalists bargain for these protections, which safeguard their interests by allowing them to influence strategic decisions and to stand first in line for payment in an M&A exit. However, these protections could also create control dynamics and conflicts of interest that could subject a transaction to entire fairness review.

Although major investors are sometimes willing to set aside their governance protections by empowering an independent special committee or conducting a majority of the minority vote, often they are not, and in some cases forming an independent committee may not even be possible due to the composition of the board. Consequently, it is not uncommon for a venture capital–financed company to conduct a sale process that would be subject to entire fairness review if challenged.

STANDARDS OF REVIEW

A board's conduct is generally assessed under the deferential "business judgment" standard, which presumes that in making a business decision the directors acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. In contrast, the entire fairness standard shifts the burden of proof and requires defendants to establish that the transaction was a product of both fair dealing and a fair price. Entire fairness is the most onerous standard of review under Delaware corporate law. The inquiry is objective—even an honest belief that a transaction is entirely fair is not sufficient to prevail—and fact-specific, with no bright-line rules for predicting a successful outcome.

Delaware courts apply the entire fairness standard to transactions approved by a conflicted board or those in which a controlling stockholder stands on both sides of the transaction or receives different treatment than other stockholders—circumstances that frequently exist in sales of venture capital–financed companies. The most obvious example arises when board members are affiliated with venture capital investors that hold preferred stock. If the interests of the preferred stockholders diverge from the interests of the common stockholders, directors affiliated with the preferred stockholders will be conflicted as "dual fiduciaries" if they owe duties to the investor that appointed them. In addition, a director will be conflicted if he or she has an individual interest in the transaction that is different than the interests of common stockholders, such as deal-related incentive arrangements. (For this purpose, "common stockholders" does not include holders of stock options, restricted stock units or other rights to acquire securities in the future, although these holders may have rights under stock plans or agreements with the company.) Finally, even if no individual investor holds a controlling stake in the company, a group of large investors may be deemed to be a "control group" if they have a legally significant arrangement to work together toward a shared goal.

A conflicted board may be remedied by delegating decision-making authority to a special committee of independent directors, and a company with a controlling stockholder can avoid application of the entire fairness standard if the special committee process is combined with a majority of the minority vote requirement. But large investors may not wish to relinquish the control they bargained for, and a board may not even be able to form a special committee if none of the directors is independent. Thus, even a well-advised board may end up on a path where entire fairness review is likely in the event of a challenge to the transaction. In that case, there are a number of factors that directors should consider to best position themselves to withstand such a challenge.

In assessing entire fairness, a court will examine whether the transaction was the product of both fair dealing and fair price.

FAIR DEALING

The first prong of the entire fairness analysis is whether the transaction was a product of fair dealing. The motives, conduct and conflicts of the transaction participants will be examined to determine whether the process that led to the transaction was fair. The inquiry examines when the transaction was timed, how it was initiated, structured, negotiated and disclosed to the directors, and how the approvals of the directors and the stockholders were obtained.

- *Timing and Initiation*: A board approving a transaction with potential conflicts must be able to justify its decision, not simply from the perspective of an individual investor's cash flow needs, distinct priorities or investment strategy, but because the transaction maximizes the value of the company for all its stockholders.
- *Structure and Negotiation*: The transaction structure should avoid discretionary elements that uniquely benefit a particular group of stockholders, or that otherwise divert value away from the common stockholders. This precaution does not prohibit honoring the liquidation preferences of the preferred stockholders,

but granting discretionary benefits to controlling stockholders or members of the board will invite unfavorable scrutiny. In addition, the transaction structure should avoid incentives that favor an outcome that benefits an interested party at the expense of the common stockholders. Management incentives are a legitimate and frequently deployed tool, but they should be structured to favor an outcome that benefits all stockholders.

— *Board Communications and Approval*: The directors should be counseled on their fiduciary duties prior to approving the transaction. A failure to understand those duties, in and of itself, may be treated as evidence of unfairness, and the board should understand that its role is to maximize the value of the company for the benefit of the common stockholders. That does not mean the transaction must represent an attractive return for common stockholders when none is offered, but the board cannot favor the interests of another constituency to the detriment of the common stockholders, and the record should reflect that the interests of the common stockholders were discussed and considered. Communications and deliberations among directors should not exclude, intentionally marginalize or withhold information from directors that are independent or otherwise aligned with the common stockholders.

— *Stockholder Communications and Approval*: Disclosure to common stockholders should adhere to any notice or disclosure requirements, whether imposed by law or the company's organizational documents, and such communications should include all material information and should not be misleading. Any perception that the board was attempting to bypass potential dissent through inadequate or misleading disclosure could be viewed as evidence of unfair dealing.

— *Valuation*: In addition to the price itself, the process by which the price was determined will be scrutinized. Directors should satisfy themselves that any valuation analysis was conducted with sufficient rigor, and should not simply rely on a valuation that they do not understand. Further, consideration should be given to the source of the valuation. An independent financial advisor or valuation firm is preferable, and a fairness opinion is also helpful, but the expense of obtaining such advice may make it impractical in many transactions. If outside financial advisors are not used, directors should avoid relying on a valuation that is not thoroughly vetted or a source that might have reason to manipulate the outcome.

No individual factor described above will necessarily be fatal. In fact, even if a process is deemed unfair as a whole it will not necessarily mean that the associated transaction will be judged "entirely unfair."

FAIR PRICE

Although the transaction process will have a significant impact on a court's overall assessment, the court's assessment of the fairness of the price is generally the more important component of the entire fairness analysis. If an unfair process yields a fair price, it is still possible that a transaction will be deemed entirely fair or that no liability will be found on the part of the board or a controlling stockholder. If common stockholders received fair value for their shares, the court may conclude that there are no damages to award, notwithstanding a faulty process.

The fairness of the price will generally be assessed based on the valuation methodologies used to support it. A valuation that reflects a blend of techniques will typically be more credible than one that relies on a single methodology. Valuations are also more persuasive if they are derived from contemporaneous management projections. A discounted cash flow analysis derived from such projections is often the most persuasive methodology (although reliance on management projections is not mandated, or wise, if there is evidence to suggest the projections are unreliable). Other techniques, such as valuations based on the trading multiples or transaction multiples of comparable companies, have also been recognized as valid approaches.

CONCLUSION

Although a transaction's process and price are typically analyzed separately, ultimately the entire fairness standard requires a single conclusion as to the fairness of the transaction. There is no precise formula for how a court will weigh the factors discussed above, but as a practical matter the achievement of a fair price is the most important step to mitigating risk to the board or a controlling stockholder. Price is more likely to be outcome-determinative than process, and even an "unfair" transaction may not yield damages if the price is fair. A court's determination as to a transaction's fairness and whether to impose damages will also be influenced by the court's characterization of the conduct of the board or a controlling stockholder. Mere failure to employ best practices will engender a more sympathetic analysis than acting in bad faith. At the extreme end of this spectrum, courts that have found malfeasance or fraud have been willing to find a transaction unfair and impose significant damage awards even when the price was determined to be within a reasonable range of fairness.

Directors and investors contemplating a transaction that could be subject to entire fairness review should carefully consider the above factors from the outset of discussions. Directors affiliated with venture capital investors, in particular, should be cognizant of their potential liability in a conflicted transaction. Director appointees could be subject to breach of fiduciary duty claims, and the venture capital firm itself may be liable for aiding and abetting such a breach, or be obligated to indemnify its director nominees against damages. In addition, if an investor is deemed a controlling stockholder, the investor may face liability for breaching its own fiduciary duties. Notwithstanding these risks and the procedural remedies that have been developed to avoid them, entire fairness transactions are still quite common in sales of private companies. Fortunately, everyone typically benefits from a higher price, and focusing on achieving the best value for stockholders collectively is always a critical step to mitigate liability risk. ■

Combating the Dramatic Rise in Federal M&A Lawsuits

In 2017, the number of federal securities class action lawsuits filed reached a record high for the second straight year. The jump is largely attributable to a sharp increase in lawsuits challenging disclosures related to mergers and acquisitions. A recent survey by Cornerstone Research found that plaintiffs filed 198 lawsuits related to M&A transaction disclosures—nearly half of all federal securities filings in 2017 (412), more than double the number of M&A lawsuits filed in 2016 (85), and nearly the same number filed in the previous five-year period (201). For those who were expecting a drop in M&A lawsuits after the Delaware Court of Chancery's decision in *In re Trulia*, the obvious question is, what happened?

Ironically, this dramatic rise appears to be the result of *Trulia's* disapprobation of "disclosure-only" settlements. Such settlements arise from lawsuits—usually filed within days of a merger announcement—that allege defendants failed to disclose material information related to the deal. Although the alleged disclosure violations are usually meritless, defendants nonetheless often will agree to disclose additional information to moot the lawsuit and ensure the deal closes on time. In exchange for these disclosures, plaintiffs voluntarily agree to dismiss the lawsuit and release all potential claims related to the deal. Later, the parties will negotiate, or the plaintiffs will petition the court for, an award of attorneys' fees.

In *Trulia*, the Delaware Court of Chancery said it would no longer approve disclosure-only settlements unless:

— the supplemental disclosures were "plainly material";

— the release of claims was limited in scope; and

— plaintiffs demonstrated that they adequately investigated any released claims.

Many observers thought that this standard would greatly reduce the number of M&A lawsuits because it eliminated the availability of "easy money" settlements (as one court termed them). And, indeed, it did reduce the number of such lawsuits filed in Delaware state court. But, in response, plaintiffs have shifted to asserting claims based on federal law, instead of state law. In so doing, they avoid the application of exclusive forum charter or bylaws provisions, which many Delaware companies have adopted and that require state law claims to be heard in the Delaware Court of Chancery. By pursuing federal claims in the federal courts, plaintiffs have avoided the Court of Chancery and litigated before courts that have not shown the same hostility to such lawsuits or settlements.

Recently, however, it appears that the federal courts may be pushing back against this type of frivolous litigation. In February, a judge in the Southern District of New York ordered plaintiffs—who filed and quickly dismissed two M&A class actions related to Time Inc.'s merger with Meredith Corporation—to show that they did not file the lawsuits for an "improper purpose." If the judge finds plaintiffs filed the lawsuits to extract a quick settlement and attorneys' fees (rather than protect shareholder interests), plaintiffs' counsel could face monetary sanctions. Such a finding could deter plaintiffs' firms from filing such lawsuits in the future.

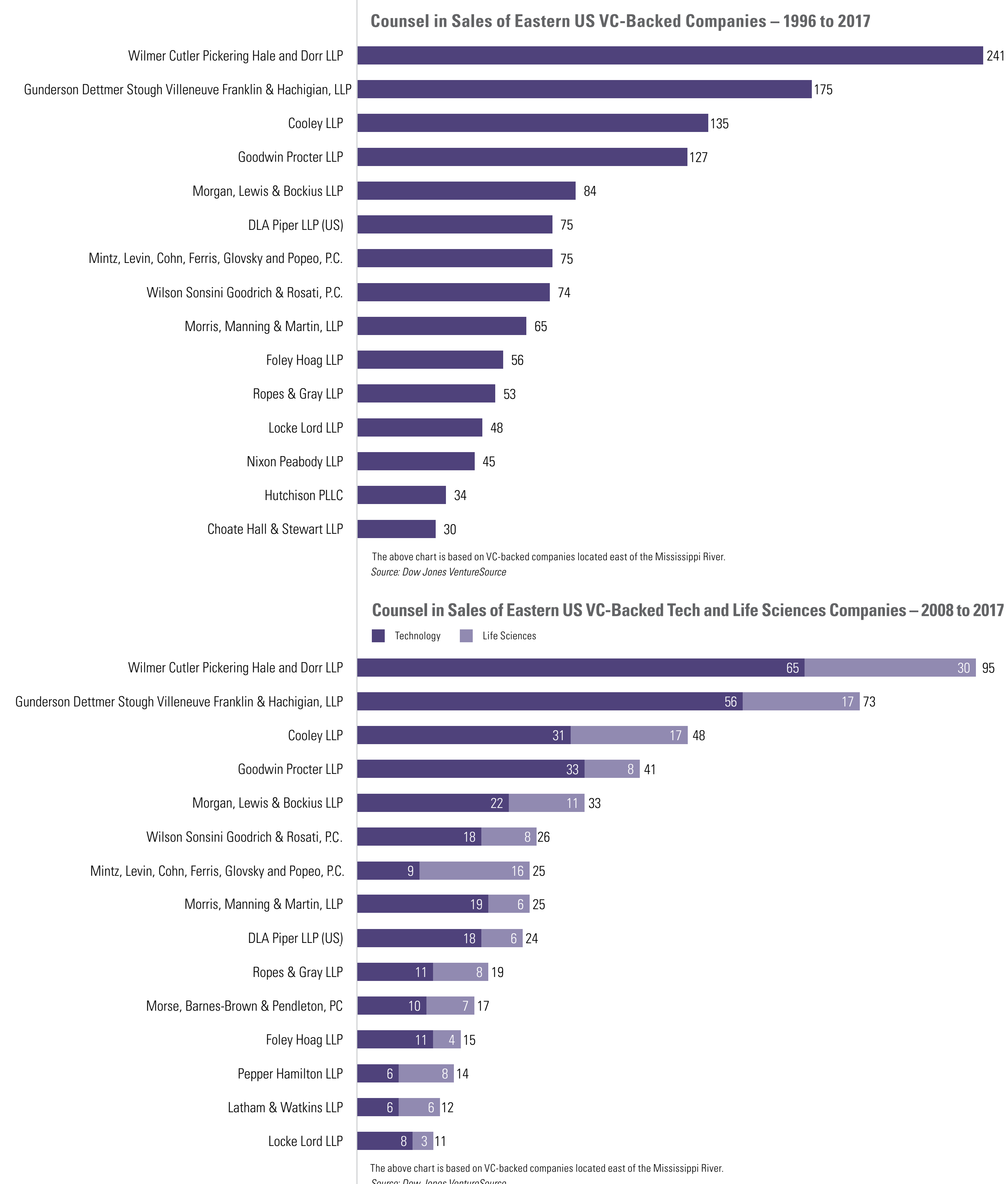
But what can companies do in the meantime to protect themselves against this scourge?

If not already incorporated in Delaware, companies could reincorporate there and adopt exclusive forum provisions to direct lawsuits to Delaware state court, thereby preventing plaintiffs from filing suit in other state courts. Although some states (like Connecticut and Michigan) have adopted *Trulia's* "plainly material" standard, others have rejected it and instead approved a more lenient approach. For instance, the New York state appeals court has held that it will approve disclosure-only settlements where the disclosures provide at least "some" benefit to shareholders and settlement is "in the best interest of the corporation." If a company is incorporated in one of the more lenient jurisdictions, it could still be exposed to the defense costs and risk of deal uncertainty posed by frivolous lawsuits. By channeling litigation to Delaware, companies can also benefit from that state's well-developed case law and its courts' familiarity with issues related to corporate litigation, and M&A litigation in particular. Other state courts, which hear these cases less frequently, may be less inclined to dismiss lawsuits that the Delaware Chancery Court would conclude are plainly meritless.

Unfortunately, exclusive forum provisions alone will not protect a company against frivolous federal lawsuits—there is little a company can do to prevent such lawsuits in the first place—and Delaware reincorporation may be impracticable for a public company. But Delaware corporations can adopt or amend their forum selection provisions to stipulate that federal claims must be brought in the Delaware federal district court. Although that court has not yet addressed the issue of disclosure-only settlements in any reported opinion, it may (after seeing a sufficient number of such meritless lawsuits) adopt the more circumspect approach of the Delaware Chancery Court and the Southern District of New York and similarly conclude that it disfavors these lawsuits and disclosure-only settlements.

The number of lawsuits could also be reduced if more companies refused to be held up and instead litigated plaintiffs' claims on the merits. Although some companies accept disclosure-only settlements because of the deal certainty they provide, these lawsuits place companies in a prisoner's dilemma. If the company settles the lawsuit quickly, it avoids a costly legal fight and gains deal certainty but in doing so it encourages plaintiffs to continue filing such lawsuits and collecting their "deal tax." The only way to break the cycle is for companies to litigate the claims, including opposing any threatened injunctions and moving to dismiss the litigation. In doing so, they could develop favorable law in various jurisdictions, and thereby force plaintiffs to internalize the cost of filing such lawsuits.

There is no panacea for the scourge of frivolous lawsuits in M&A transactions, but the strategies outlined above should, over time, reduce the number of these lawsuits. ■


Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2017
Wilmer Cutler Pickering Hale and Dorr LLP 241
Gunderson Dettmer Stough Villeneuve Franklin & Hachigian, LLP 175
Cooley LLP 135
Goodwin Procter LLP 127
Morgan, Lewis & Bockius LLP 84
DLA Piper LLP (US) 75
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C. 75
Wilson Sonsini Goodrich & Rosati, P.C. 74
Morris, Manning & Martin, LLP 65
Foley Hoag LLP 56
Ropes & Gray LLP 53
Locke Lord LLP 48
Nixon Peabody LLP 45
Hutchison PLLC 34
Choate Hall & Stewart LLP 30
The above chart is based on VC-backed companies located east of the Mississippi River.
Source: Dow Jones VentureSource
Counsel in Sales of Eastern US VC-Backed Tech and Life Sciences Companies – 2008 to 2017
Technology
Life Sciences
Wilmer Cutler Pickering Hale and Dorr LLP 65 30 95
Gunderson Dettmer Stough Villeneuve Franklin & Hachigian, LLP 56 17 73
Cooley LLP 31 17 48
Goodwin Procter LLP 33 8 41
Morgan, Lewis & Bockius LLP 22 11 33
Wilson Sonsini Goodrich & Rosati, P.C. 18 8 26
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C. 9 16 25
Morris, Manning & Martin, LLP 19 6 25
DLA Piper LLP (US) 18 6 24
Ropes & Gray LLP 11 8 19
Morse, Barnes-Brown & Pendleton, PC 10 7 17
Foley Hoag LLP 11 4 15
Pepper Hamilton LLP 6 8 14
Latham & Watkins LLP 6 6 12
Locke Lord LLP 8 3 11
The above chart is based on VC-backed companies located east of the Mississippi River.
Source: Dow Jones VentureSource

Counsel of Choice for Mergers and Acquisitions

Serving industry leaders in technology, life sciences, cleantech, financial services, communications and beyond

Acquisition by
Sycamore Partners
$6,900,000,000
September 2017

Acquisition of
RAGE Frameworks
$125,000,000
April 2017

Acquisition of
Nominum
Undisclosed
November 2017

Acquisition of
CoreOS
$250,000,000
January 2018

Acquisition by
Crane Co.
$800,000,000
January 2018

Acquisition by
Marlin Equity Partners
$278,000,000
June 2017

Sale of medical imaging business to
Varian Medical Systems
$276,000,000
May 2017

Acquisition of
Linear Technology
$14,800,000,000
(co-counsel)
March 2017

The Medicines Company

Sale of global portfolio of hemostasis products to
Mallinckrodt
$410,000,000
(including contingent payments)
February 2016

CIRCOR

Acquisition of fluid handling business of
Colfax
$855,000,000
December 2017

Acquisition by
Medline
Undisclosed
December 2017

Acquisition of raxibacumab antibody from
GlaxoSmithKline
$76,000,000
(plus contingent payments)
July 2017

Acquisition of
Serena Software
$540,000,000
(co-counsel)
May 2016

Acquisition by
Euronext
$153,000,000
June 2017

Acquisition of
Kinvey
$49,000,000
June 2017

Acquisition of
Newport Corporation
$980,000,000
April 2016

Hilton

Sale of 25% equity interest by Blackstone to
HNA Tourism Group
$6,500,000,000
(counsel to special committee)
March 2017

Acquisition by
Sucampo Pharmaceuticals
$200,000,000
April 2017

Acquisition by
Astellas Pharma
$450,000,000
(including contingent payments)
January 2018

NAVIENT

Acquisition of
Earnest
$155,000,000
November 2017

ThermoFisher SCIENTIFIC

Acquisition of
Finesse Solutions
$221,000,000
February 2017

PTC

Acquisition of all rights to EMFLAZA™ (deflazacort) from
Marathon Pharmaceuticals
$140,000,000
(plus contingent payments)
April 2017

workmarket

Acquisition by
ADP
$125,000,000
January 2018

GILT

Acquisition by
Hudson's Bay Company
$250,000,000
February 2016

CYNOSURE

Acquisition by
Hologic
$1,650,000,000
March 2017

Combination with GENBAND to form
Ribbon Communications
$745,000,000
October 2017

Acquisition by
OSI Systems
$269,000,000
September 2016

Acquisition by
salesforce.com
$2,800,000,000
July 2016

Acquisition by
Altaris Capital Partners
$1,100,000,000
Pending
(as of May 31, 2018)

Acquisition of
Electronic Funds Source
$1,485,000,000
July 2016

VALENCE

Formation transaction through combination of
Billboard-Hollywood Reporter Media Group, dick clark productions and MRC
$3,000,000,000
(enterprise value)
January 2018

Acquisition of Trayport from
Intercontinental Exchange
£550,000,000
and concurrent
Sale of Natural Gas Exchange and Shorcan Energy to
Intercontinental Exchange
£200,000,000
December 2017

Preparing for Your Cross-Border Deal

Cross-border M&A transactions often pose challenges not present in domestic deals. Discussed below are some critical steps to help make your next cross-border transaction a success.

DEAL TEAM AND TRANSACTION STRUCTURE

Assembling a strong deal team is critical. Your internal team should cover the key functions relevant to the transaction, including legal, finance, tax, compliance, human resources, IT, facilities and general management.

Your external team should include lead outside counsel and local counsel for specific jurisdictions. Select a lead counsel with experience working on cross-border deals and strong project management skills, in addition to legal expertise. Because each country has its own legal, financial, regulatory and tax regimes, lead outside counsel in a significant cross-border deal will need to manage local counsel in disparate jurisdictions. Local counsel expertise may be particularly relevant in places where foreign investment is relatively new.

Local law issues often have a major impact on deal structure, closing conditions and closing timeline. Tax considerations can be a key driver in structuring cross-border M&A transactions, and differences in accounting standards can also matter. Determining a deal structure and approach that achieves the parties' objectives up front will avoid the time and expense of restructuring the transaction later.

DUE DILIGENCE

Comprehensive commercial, financial and legal due diligence can help uncover risks and ensure a proper deal valuation and risk allocation. Issues will vary, and you will need to assess each problem for its significance and likelihood, as well as for ways to mitigate or eliminate that risk. And of course, some risks may be deal killers. While this exercise is important in all deals, its importance is magnified in cross-border deals, particularly if the target has operations in jurisdictions with an underdeveloped legal or regulatory framework. For example, determining whether a counterparty to a contract has a consent right under local law might be challenging in the absence of applicable law or judicial interpretations.

Regulatory compliance is often a major focus of diligence in cross-border transactions. Your compliance team should review the target's compliance programs and practices to identify any gaps and issues that you will want to address immediately after closing. You may advise that the target company undertake additional procedures pre-closing or determine whether self-reporting or disclosure to the applicable agency is required or advisable. Where necessary or appropriate, tailor compliance programs to meet local jurisdictional requirements. For example, data security and privacy restrictions are more stringent in Europe than in the United States. A non-European buyer's data security and privacy policies and procedures may need to be updated to comply with these more restrictive standards.

Once you have completed diligence, assessed the risks in doing a deal and identified areas that either the buyer or the acquired business will need to change once the deal closes, you need to make sure the transaction documents appropriately address and allocate deal risks between the buyer and the seller. Risk allocation is typically accomplished through representations and warranties, indemnities, covenants (pre-closing and post-closing) and closing conditions.

Deal terms will also vary depending on the governing law and what is acceptable and customary in the relevant jurisdiction. For example, mergers and acquisitions in the United Kingdom often contain less extensive representations and warranties and fewer bring-down closing conditions than deals in the United States. As a result, once a deal is announced in the United Kingdom, parties are expected to close, barring any extraordinary circumstances. By contrast, deals in China will often include a contingency clause stating that the terms of the agreement will only become effective upon relevant government approval.

THIRD-PARTY AND GOVERNMENTAL APPROVALS

Obtaining third-party approvals is usually a part of any deal, and may play an even larger role in cross-border deals if international third parties, including customers and suppliers, have more leverage than smaller, local third parties. If consent is not contractually required, it may still be a smart strategic move to meet with select third parties to share an overview of the proposed deal. This effort can help minimize deal risk because it can address customer and supplier concerns and ensure third-party satisfaction as the deal moves forward.

Third parties may sometimes be uncooperative and oppose the proposed deal. For example, a third party may object if it feels that the buyer is a competitor, or may exploit the opportunity to renegotiate more favorable terms in its own agreement with the target company. In such a case, you must assess the cost of losing the third party and determine whether to implement a purchase price adjustment or a walkaway right in the transaction document.

Consents from government and regulatory agencies are another critical piece of cross-border deals. These agencies operate on their own timeline and may raise issues, ask questions or require additional information. You should budget extra time to accommodate requests and respond to questions.

One strategy for preventing delays and fostering a positive relationship with relevant agencies is to preview the proposed transaction with them. Government and regulatory agencies usually appreciate advance warning and, as a result, may be more receptive if you reach out to them early in deal discussions. These discussions can also help flesh out any issues or questions you need to address when you still have the time and bandwidth to do so.

LABOR LAW

Every jurisdiction has its own—often complex—labor and employment laws, customs and regulations, and a cross-border transaction may introduce you

to new or different labor law requirements. In addition, labor unions (or works councils) are more prevalent in European countries than elsewhere and may have more power than in the United States to influence or shape transactions. For example, overseas unions may have approval rights over transactions or may give their employees rights such as advance notice, information and consultation regarding an upcoming transaction.

Some labor laws apply specifically to employee rights in the context of mergers and acquisitions. In the United States, an asset acquisition can be a fresh start for compensation and benefits, but European countries may require the surviving entity to continue the workers' employment under identical terms and compensation. Asset purchases may, in some countries, trigger a "transfer of undertaking," which restricts the employer's right to make employees redundant. Entering into a deal overseas with the expectation of significant synergies and cost-cutting can lead to disappointment if labor laws are not factored in.

ANTITRUST CONSIDERATIONS

Every cross-border M&A transaction is subject to scrutiny by the government for potential antitrust violations, and this review may extend beyond the countries where the two businesses are primarily based. The substantive standards for the antitrust review of a merger or acquisition are similar in most countries—antitrust agencies typically ask whether the transaction substantially lessens competition in any relevant market—but there are significant procedural differences. For example, in the United States, most Hart-Scott-Rodino (HSR) Act filings for reportable transactions are submitted without prior discussions with the antitrust enforcement agencies, and agency questions are addressed after the filing has been submitted and the HSR waiting periods have started to run. In the European Union and many other jurisdictions, by contrast, it is customary to engage in pre-notification discussions with the local antitrust agency, a process that can take weeks or months depending on the complexity of the transaction. These procedural differences can have a significant impact on deal timing and require careful planning, especially in large deals.

Failure to follow mandated procedures in all relevant jurisdictions—even if the jurisdiction has only a tangential relationship to the parties—may result in significant fines and possibly a demand to alter or even undo the deal. To avoid potential snags, you should conduct an antitrust filing review and a competitive landscape market check before signing a cross-border deal. Even if the transaction does not require notice or consent, however, some government and regulatory agencies may still investigate the transaction and potentially act against it.

POLITICAL ENVIRONMENT

Don't underestimate the impact on a deal of the political environment in any country where the parties conduct business. For example, the Trump Administration in the United States is seeking to change the regulatory landscape affecting businesses operating in the United States, both through executive orders and legislation. The United Kingdom voted in 2016 to leave the European Union, resulting in increased uncertainty in cross-border deals involving British companies. As you move forward in deal discussions, stay abreast of current and anticipated political and regulatory changes that may affect your company and the proposed deal.

COMMUNICATIONS STRATEGY

You should develop a two-pronged communications approach for your deal: an internal strategy for employees and an external one for the media, analysts and the public, including customers, vendors and officials. Your communications plan needs to comply with confidentiality obligations and other relevant rules and regulations, including listing requirements. Despite confidentiality precautions, you should be prepared for leaks, which may trigger disclosure obligations.

Internal communications should address potentially sensitive issues such as layoffs, labor disputes and plant closures or relocations. Depending on the size and nature of the transaction, you may want to hold an all-hands meeting to share the news with employees.

Public disclosure may be required depending on the jurisdiction and the stage of the deal. Public companies are generally subject to broader disclosure requirements than private ones. If the deal is significant, expect questions from investors and the media as well as from customers, suppliers, vendors, landlords and local community leaders. Public companies often hold conference calls with investors and analysts shortly after announcing a major transaction.

CONTINGENCY PLANS

Cross-border deals often move slower and face more hurdles than domestic transactions. Maintain alternative options at each stage of the deal. Bottlenecks can often be avoided through careful planning and by being flexible. For example, if antitrust issues are expected to arise, consider transferring problematic assets to a separate standalone entity for efficient divestiture if required by antitrust authorities.

POST-CLOSING

Once the transaction is closed, you should assess the deal process and pinpoint how any setbacks and delays could be more effectively handled in future deals. You should also consider the objectives of the transaction and whether they were obtained. Although each acquisition is unique, and the strategic and operational decisions that make sense in one transaction may not translate to another, critical self-assessment of a completed deal will help you plan for future deals.

CONCLUSION

Cross-border deals raise a number of unique legal issues that can quickly derail or significantly delay a deal, or that can lead to unfortunate post-closing consequences for the buyer. Careful planning—combined with a disciplined, systematic approach to the entire transaction—can go a long way toward ensuring that your next cross-border deal is a success. ■

Not so long ago, a businessperson might have been as likely to guess that "CFIUS" was a novel strain of virus or a new intelligence agency as to identify it as an acronym for the Committee on Foreign Investment in the United States, the US government's interagency body that vets foreign investments and acquisitions with national security implications. In recent years, however, several prominent transactions have elevated CFIUS from relative obscurity to the front pages, and M&A issues associated with CFIUS have continued to increase.

These developments are pointed reminders that, although the United States historically has prided itself on openness to foreign investments, such transactions are likely to pose heightened regulatory and political concerns in the current environment. Parties to potential foreign acquisitions of US companies or assets need to consider CFIUS carefully in planning—and potentially in valuing—their transactions.

In 2017, CFIUS reviewed more cases (approximately 240) than in any prior year. At the same time, the types of transactions that may trigger CFIUS issues continued to expand. In the past, CFIUS principally focused on transactions associated with aerospace, defense, energy, advanced technologies and telecommunications companies. Now, CFIUS increasingly focuses on transactions that involve a wider range of economic sectors, such as critical infrastructure, natural resources, large data sets, agriculture and any technology perceived as being important for US military and security competitiveness.

Concern about Chinese investment in the United States has become particularly acute, and may increase further with heightened trade tensions between the two countries. Although CFIUS has approved several Chinese investments over the past year, nearly all Chinese investments encountered a complicated CFIUS review process. The US intelligence community generally views "Chinese actors [as] the world's most active and persistent perpetrators of economic espionage," a view seemingly shared by the Trump Administration. In light of these concerns, the Director of National Intelligence stated in May 2017 congressional testimony that "[g]iven China's aggressive approach relative to information gathering . . . [there should be] a review of CFIUS in terms of whether or not it . . . needs to have some changes or innovations to address the aggressive Chinese actions not just against our companies, but across the world."

Largely driven by anxiety about the threat to US technology leadership posed by foreign actors, a bipartisan group from Congress and the executive branch has publicly endorsed reforms to expand CFIUS jurisdiction. In late 2017, the Foreign Investment Risk Review Modernization Act (FIRRMA) was introduced in Congress. If enacted, FIRRMA would make substantial changes to the current CFIUS regime and set the stage for a potential increase in regulatory scrutiny for transactions associated with investment from China and other foreign countries "of special concern" in the United States.

CURRENT LAW

Under current law, CFIUS has the power to review any "covered transaction" to determine the effect of the transaction on the national security of the United States. A "covered transaction" is any merger, acquisition or investment that "could result" in a foreign person exercising "control" of a person or entity "engaged in interstate commerce in the United States."

For CFIUS purposes, "control" is a term of art that turns on an assessment of whether a transaction could empower a foreign person to direct important matters affecting a US business. As a general rule, where a party acquires a substantial equity position in a company plus the power to appoint individuals to the company's board, that party has "control" for CFIUS purposes. Although CFIUS has jurisdiction over all covered transactions, without limitation to type of business, as a practical matter CFIUS's exercise of its review authority has traditionally focused on transactions that raise plausible national security concerns.

A CFIUS filing is technically voluntary, but CFIUS has broad authority to initiate an investigation of any covered transaction over which it has jurisdiction and that may raise national security issues, whether or not a CFIUS filing is made. For transactions that are not submitted for review, CFIUS retains the ability to examine the transaction after closing and may impose mitigation measures for any national security concerns. In rare cases, the president may order divestment of acquired businesses if the transaction is sensitive.

CFIUS has several tools available to address perceived risks from a transaction. At the extreme end, the president has the power to block a transaction or to order a divestment to protect national security, although the use of such authority is very rare. More often, CFIUS seeks to impose mitigation terms through an agreement among the parties and the government. Such mitigation terms can range from the relatively innocuous (such as annual reports to CFIUS about any change in a foreign entity's equity position) to the intrusive (such as limitations on sales to certain economic sectors and substantial controls around visits with foreign nationals).

For several years, the number of transactions encountering CFIUS problems has grown, prompting more foreign buyers to assess CFIUS issues before making investments in or acquiring US companies.

REFORM EFFORTS

FIRRMA contains several measures that, if adopted, would significantly expand CFIUS jurisdiction and add new factors for CFIUS to consider in evaluating covered transactions. Many of these measures appear designed to address concerns of members of Congress and other advocates for CFIUS reform in connection with:

- US technological superiority in key industries;
- "investment-driven" technology transfers;
- perceived efforts by foreign buyers to structure transactions to avoid CFIUS jurisdiction; and
- joint ventures between US and foreign companies that are not currently subject to CFIUS jurisdiction.

Of particular note, FIRRMA would amend the Defense Production Act of 1950 by broadening the scope of "covered transactions" that are subject to CFIUS review, and by adding or amending several key terms. Under FIRRMA, "covered transactions" would include not just any merger, acquisition or takeover by a foreign person that could result in foreign control of a US business, but would also include:

- a non-passive investment by a foreign person in any US-critical technology company or critical infrastructure company;
- the contribution by a US-critical technology company of both intellectual property and associated support to a foreign person through a joint venture or other arrangement;
- any change in a foreign investor's rights in a US business if such change could result in either foreign control of the business or in a non-passive investment;
- the purchase or lease by a foreign person of US real estate in close proximity to military or other US national security facilities; and
- any other transaction the structure of which is designed to circumvent CFIUS.

FIRRMA would essentially require a significantly more comprehensive analysis of any potential transaction that relates to US-critical technology or critical infrastructure companies, including the transfer of intellectual property out of the United States through a joint venture. It would also require scrutiny of passive investments, real estate transactions and other transactions that were previously outside of CFIUS jurisdiction.

In addition to broadening the scope of covered transactions subject to CFIUS review, FIRRMA would require CFIUS to consider nine new factors in its analysis of covered transactions, although many of these factors would codify existing practice more than reflect actual changes in policy:

- the degree to which the transaction would increase US government costs associated with acquiring or maintaining equipment and systems necessary for defense, intelligence or other national security functions;
- the potential national security–related effects of the cumulative market share of any one type of infrastructure, energy asset, critical material or critical technology by foreign persons;
- the compliance record of the foreign person who would acquire an interest in a US business or its assets (that is, the person's record in connection with US laws and regulations governing exports, IP protection, immigration and federal procurement);
- the risk that personally identifiable information, genetic information or other sensitive data of US citizens would be exposed, directly or indirectly, to access by a foreign government or foreign person that may exploit such information in a manner that threatens national security;
- the prospect that the transaction is likely to effectively create new cybersecurity vulnerabilities in the United States or exacerbate existing vulnerabilities;
- whether the transaction is likely to result in a foreign government gaining significant new capabilities to engage in malicious cyber-enabled activities against the United States, including those "designed to affect the outcome of any election for federal office;"
- whether the transaction involves a country of special concern that has demonstrated a strategic goal of acquiring a type of critical technology that the subject US business possesses;
- the prospect that the transaction is likely to facilitate criminal or fraudulent activity that would affect US national security; and
- whether the transaction is likely to expose sensitive national security information or sensitive procedures or operations of a federal law enforcement agency with national security responsibilities to a foreign person not authorized to receive such information.

LOOKING AHEAD

By establishing special review criteria for countries "of special concern," FIRRMA's reforms could result in far greater scrutiny of transactions associated with investments from countries such as China than exists under today's CFIUS regulations. Although a congressional sponsor of FIRRMA has stated that "CFIUS was not created with China in mind," he has also said that reform could "plug the gaps" that exist in the current CFIUS process in connection with Chinese and other foreign investment.

Regardless of FIRRMA's intentions or ultimate fate, CFIUS appears likely to continue to play an increasingly important role in M&A transactions involving foreign parties. US companies contemplating an acquisition by a foreign buyer—or an investment from a foreign investor—should be more attuned than ever to the potential impact of the CFIUS factor. ■

RECENT TRANSACTIONS DERAILED BY CFIUS

High-profile transactions that have stumbled in the past two years as a result of CFIUS include:

- *Broadcom/Qualcomm* (2018)—President Trump issued an order blocking Broadcom's attempted $112 billion hostile takeover of Qualcomm even before CFIUS review was complete.
- *Lattice Semiconductor/Canyon Bridge* (2017)—President Trump blocked the proposed $1.4 billion acquisition of Lattice Semiconductor Corp. by a private equity firm that was reportedly financed by the Chinese government.
- *Aixtron SE/Fujian Grand Chip Investment Fund LP* (2016)—President Obama blocked the proposed sale of the US portion of a German microchip equipment manufacturer by Grand Chip Investment GmbH to a company owned by Chinese investors with ties to the Chinese government.
- *Philips Lumileds* (2016)—Philips abandoned the proposed sale of LED maker Lumileds after CFIUS reportedly indicated its intention to recommend that the president block the transaction; the proposed buyer was a consortium that included two Chinese investors.

FCPA Considerations in M&A Transactions

The Foreign Corrupt Practices Act (FCPA) is a criminal and securities statute that is jointly enforced by the Department of Justice (DOJ) and the SEC. The FCPA has two components:

— The statute prohibits any company, whether private or public, as well as its officers, directors, employees, stockholders and agents, from making or offering corrupt payments to foreign government officials.

— The statute requires every public company to maintain accurate books and records and to implement adequate internal accounting controls. This requirement is in addition to the internal control requirements imposed by the Sarbanes-Oxley Act.

Investigations and enforcement proceedings under the FCPA have been instituted in record numbers over the past several years, resulting in the payment of billions of dollars in fines and penalties. Many of these proceedings have arisen in the M&A context. Companies engaged in acquisition activity should understand the risks posed by FCPA violations and the steps that can be taken to reduce those risks.

US enforcement authorities have made clear their expectation that purchasers of transnational businesses will conduct pre-acquisition FCPA due diligence and will, post-closing, promptly implement appropriate FCPA remediation and compliance integration steps. The joint FCPA guidance issued in 2012 by the DOJ and SEC, as well as the DOJ's 2017 compliance program guidance, describe pre-acquisition due diligence and post-acquisition integration as among the hallmarks of an effective compliance program. These pronouncements by enforcement agencies, coupled with the results of recent enforcement proceedings, underscore the need for both purchasers and sellers to evaluate FCPA risks and pursue related risk-mitigation strategies when undertaking transactions.

There are generally three types of FCPA risks for a purchaser in an M&A transaction, any of which may expose it to greater regulatory scrutiny or hurt its stock price.

— ***Legal Risks***: A purchaser may acquire legacy as well as prospective legal liability, depending on the circumstances of the acquisition. For example, a purchaser who fails to detect ongoing bribery by the target may inherit the legacy liability of the target for past misconduct, as well as incurring liability for misconduct after the purchase, when the purchaser is responsible for the target's compliance with the FCPA.

— ***Financial Risks***: A target may not be properly valued if FCPA issues are not identified. For example, a purchaser may discover after the closing that it faces civil and criminal financial penalties, the loss of government contracts that have been obtained through corrupt conduct, or the need to terminate the employment of key personnel who have been involved in misconduct.

— ***Reputational Risks***: Misconduct by a target may tarnish a purchaser's compliance record.

To manage these risks, purchasers in M&A transactions should take affirmative steps to address FCPA issues both pre- and post-closing. While there may be impediments to conducting extensive diligence in some types of transactions (such as auctions or hostile takeovers), purchasers should resist pressures to "get the deal done" without adequate diligence appropriate to the risks of the transaction. The key steps purchasers should take include the following:

— ***Due Diligence***: Before entering into an acquisition agreement, the purchaser should develop a profile of the target in six areas: the geographic regions in which the target operates and the level of corruption risk in each one; the target's industry and business operations, including its interactions with government officials; the target's past business practices; the target's corporate structure, subsidiaries and joint ventures; the target's relationships with its third-party business partners, such as agents, consultants and distributors; and the target's anti-corruption compliance program. Depending on the level of anti-corruption risk that results from this profile, the depth of follow-up diligence may vary. Typically, at a minimum, informational interviews with key employees of the target and a review of basic documentation should be undertaken. If the anti-corruption risk appears higher, site visits, forensic transaction review, detailed interviews of employees of the target and interviews with the target's third-party representatives may be warranted. If adequate pre-closing diligence is not possible, it should be completed soon after closing.

— ***Transaction Documents***: The negotiation of acquisition documents also provides the purchaser with an opportunity to mitigate FCPA risk from the transaction. If diligence has revealed (or the purchaser suspects diligence will reveal) potential FCPA liability, the purchaser should consider provisions such as representations that the target has not engaged in corrupt conduct; a closing condition that the purchaser shall have completed FCPA diligence to the purchaser's satisfaction; indemnities from the seller for FCPA penalties and investigation costs; and provisions governing the joint investigation and possible disclosure of potential FCPA liabilities to the government.

— ***Post-Closing Actions***: Once the purchaser assumes control of the target, the purchaser should quickly ensure that FCPA issues identified in due diligence are fully addressed; improper conduct detected through diligence is stopped; appropriate remediation steps are implemented; and an effective compliance program is instituted at the target, including training of the target's staff.

Sellers also face FCPA-related risks in M&A transactions. A purchaser's FCPA due diligence may uncover questionable payments or call into question the adequacy of the seller's internal controls. Purchasers are increasingly incentivized by DOJ policies to push sellers to disclose FCPA issues to the government before an acquisition is completed, potentially leading to government investigation of and enforcement proceedings against the seller. These factors could affect whether the transaction can be consummated and, if so, on what terms. In addition, sellers face potential risks if their FCPA representations and warranties are inaccurate. As a result, sellers should consider conducting their own due diligence prior to embarking on an M&A transaction, in order to ensure that their representations and warranties to the purchaser are accurate, as well as to anticipate potential FCPA enforcement issues. ■

Public and private company M&A transactions share many characteristics, but also involve different rules and conventions. Described below are some of the ways in which acquisitions of public and private targets differ.

GENERAL CONSIDERATIONS

The M&A process for public and private company acquisitions differs in several respects:

— ***Structure***: An acquisition of a private company may be structured as an asset purchase, a stock purchase or a merger. A public company acquisition is generally structured as a merger, often in combination with a tender offer for all-cash acquisitions.

— ***Letter of Intent***: If a public company is the target in an acquisition, there is usually no letter of intent. The parties typically go straight to a definitive agreement, due in part to concerns over creating a premature disclosure obligation. Sometimes an unsigned term sheet is also prepared.

— ***Timetable***: The timetable before signing the definitive agreement is often more compressed in an acquisition of a public company. More time may be required between signing and closing, however, because of the requirement to prepare and file disclosure documents with the SEC and comply with applicable notice and timing requirements, and the need in many public company acquisitions for antitrust clearances that may not be required in smaller, private company acquisitions.

— ***Confidentiality***: The potential damage from a leak is much greater in an M&A transaction involving a public company, and accordingly rigorous confidentiality precautions are taken.

— ***Director Liability***: The board of a public target will almost certainly obtain a fairness opinion from an investment banking firm and is much more likely to be challenged by litigation alleging a breach of fiduciary duties.

DUE DILIGENCE

When a public company is acquired, the due diligence process differs from the process followed in a private company acquisition:

— ***Availability of SEC Filings***: Due diligence typically starts with the target's SEC filings—enabling a potential acquirer to investigate in stealth mode until it wishes to engage the target in discussions.

— ***Speed***: The due diligence process is often quicker in an acquisition of a public company because of the availability of SEC filings, thereby allowing the parties to focus quickly on the key transaction points.

MERGER AGREEMENT

The merger agreement for an acquisition of a public company reflects a number of differences from its private company counterpart:

— ***Representations***: In general, the representations and warranties from a public company are less extensive than those from a private company; are tied in some respects to the accuracy of the public company's SEC filings; may have higher materiality thresholds; and, importantly, do not survive the closing.

— ***Exclusivity***: The exclusivity provisions are subject to a "fiduciary exception" permitting the target to negotiate with a third party making an offer that may be deemed superior and to change the target board's recommendation to stockholders.

— ***Closing Conditions***: The closing conditions in the merger agreement, including the "no material adverse change" condition, are generally drafted so as to limit the target's closing risk and give the acquirer little room to refuse to complete the transaction if regulatory and stockholder approvals are obtained.

— ***Post-Closing Obligations***: Post-closing escrow or indemnification arrangements are extremely rare.

— ***Earnouts***: Earnouts are unusual, although a form of earnout arrangement called a "contingent value right" is not uncommon in the life sciences sector.

— ***Deal Certainty and Protection***: The negotiation battlegrounds are the provisions addressing deal certainty (principally the closing conditions) and deal protection (exclusivity, voting agreement, termination and breakup fees).

SEC INVOLVEMENT

The SEC plays a role in acquisitions involving a public company:

— ***Form S-4***: In a public acquisition, if the acquirer is issuing stock to the target's stockholders, the acquirer must register the issuance on a Form S-4 registration statement that is filed with (and possibly reviewed by) the SEC.

— ***Stockholder Approval***: Absent a tender offer, the target's stockholders, and sometimes the acquirer's stockholders, must approve the transaction. Stockholder approval is sought pursuant to a proxy statement that is filed with (and often reviewed by) the SEC. Public targets seeking stockholder approval generally must provide for a separate, non-binding stockholder vote with respect to all compensation each named executive officer will receive in the transaction.

— ***Tender Offer Filings***: In a tender offer for a public target, the acquirer must file a Schedule TO and the target must file a Schedule 14D-9. The SEC staff reviews and often comments on these filings.

— ***Public Communications***: Elaborate SEC regulations govern public communications by the parties in the period between the first public announcement of the transaction and the closing of the transaction.

— ***Multiple SEC Filings***: Many Form 8-Ks and other SEC filings are often required by public companies that are party to M&A transactions.

Set forth on the following page is a comparison of selected deal terms in public target and private target acquisitions, based on the most recent studies available from SRS Acquiom (a provider of post-closing transaction management services) and the Mergers & Acquisitions Committee of the American Bar Association's Business Law Section. The SRS Acquiom study covers private target acquisitions in which it served as shareholder representative and that closed in 2017. The ABA private target study covers acquisitions that were completed in 2016 and the first half of 2017, and the ABA public target study covers acquisitions that were announced in 2016 (excluding acquisitions by private equity buyers).

COMPARISON OF SELECTED DEAL TERMS

The accompanying chart compares the following deal terms in acquisitions of public and private targets:

— ***"10b-5" Representation***: A representation to the effect that no representation or warranty by the target contained in the acquisition agreement, and no statement contained in any document, certificate or instrument delivered by the target pursuant to the acquisition agreement, contains any untrue statement of a material fact or fails to state any material fact necessary, in light of the circumstances, to make the statements in the acquisition agreement not misleading.

— ***Standard for Accuracy of Target Representations at Closing***: The standard against which the accuracy of the target's representations and warranties set forth in the acquisition agreement is measured for purposes of the acquirer's closing conditions (sometimes with specific exceptions):

- A "MAC/MAE" standard provides that each of the representations and warranties of the target must be true and correct in all respects as of the closing, except where the failure of such representations and warranties to be true and correct will not have or result in a *material adverse change/effect on the target.*
- An "in all material respects" standard provides that the representations and warranties of the target must be true and correct *in all material respects* as of the closing.
- An "in all respects" standard provides that each of the representations and warranties of the target must be true and correct *in all respects* as of the closing.

— ***Inclusion of "Prospects" in MAC/MAE Definition***: Whether the "material adverse change/effect" definition in the acquisition agreement includes "prospects" along with other target metrics, such as the business, assets, properties, financial condition and results of operations of the target.

— ***Fiduciary Exception to "No-Shop/No-Talk" Covenant***: Whether the "no-shop/no-talk" covenant prohibiting the target from seeking an alternative acquirer includes an exception permitting the target to consider an unsolicited superior proposal if required to do so by its fiduciary duties.

— ***Opinion of Target's Counsel as Closing Condition***: Whether the acquisition agreement contains a closing condition requiring the target to obtain an opinion of counsel, typically addressing the target's due organization, corporate authority and capitalization; the authorization and enforceability of the acquisition agreement; and whether the transaction violates the target's corporate charter, bylaws or applicable law. (Opinions regarding the tax consequences of the transaction are excluded from this data.)

— ***Appraisal Rights Closing Condition***: Whether the acquisition agreement contains a closing condition providing that appraisal rights must not have been sought by target stockholders holding more than a specified percentage of the target's outstanding capital stock. (Under Delaware law, appraisal rights generally are not available to stockholders of a public target when the merger consideration consists solely of publicly traded stock.)

— ***Acquirer MAC/MAE Closing Condition***: Whether the acquisition agreement contains a closing condition excusing the acquirer from closing if an event or development has occurred that has had, or could reasonably be expected to have, a "material adverse change/effect" on the target. Requiring the target's MAC/MAE representation to be "brought down" to closing has the same effect.

"10b-5" Representation	
PUBLIC (ABA)	1%
PRIVATE (ABA)	26%
PRIVATE (SRS ACQUIOM)	28%

Standard for Accuracy of Target Representations at Closing	
PUBLIC (ABA)	
"MAC/MAE"	99%
"In all material respects"	None
Other standard	1%
PRIVATE (ABA)	
"MAC/MAE"	48%
"In all material respects"	50%
"In all respects"	2%
PRIVATE (SRS ACQUIOM)	
"MAC/MAE"	41%
"In all material respects"	56%
"In all respects"	3%

Inclusion of "Prospects" in MAC/MAE Definition	
PUBLIC (ABA)	None
PRIVATE (ABA)	15%
PRIVATE (SRS ACQUIOM)	10%

Fiduciary Exception to "No-Shop/No-Talk" Covenant	
PUBLIC (ABA)	100%
PRIVATE (ABA)	11%
PRIVATE (SRS ACQUIOM)	5%

Opinion of Target's Counsel as Closing Condition	
PUBLIC (ABA)	–
PRIVATE (ABA)	7%
PRIVATE (SRS ACQUIOM)	8%

Appraisal Rights Closing Condition	
PUBLIC (ABA)	
All cash deals	4%
Part cash/part stock deals	11%
PRIVATE (ABA)	
All deals	57%
PRIVATE (SRS ACQUIOM)	
All deals	58%

Acquirer MAC/MAE Closing Condition	
PUBLIC (ABA)	100%
PRIVATE (ABA)	93%
PRIVATE (SRS ACQUIOM)	97%

TRENDS IN SELECTED DEAL TERMS

The ABA deal-term studies have been published periodically since 2004. A review of past ABA studies identifies the following trends, although in any particular transaction negotiated outcomes may vary (not all metrics discussed below were reported for all periods):

In transactions involving *public* company targets:

— ***"10b-5" Representations***: These representations, whose frequency had fallen steadily from a peak of 19% of acquisitions announced in 2004, were present in only 1% of acquisitions announced in 2016.

— ***Accuracy of Target Representations at Closing***: The MAC/MAE standard for accuracy of the target's representations at closing remains almost universal, present in 99% of acquisitions announced in 2016 compared to 89% of acquisitions announced in 2004. In practice, this trend has been offset to some extent by the use of lower standards for specific representations, such as those relating to capitalization and authority.

— ***Inclusion of "Prospects" in MAC/MAE Definition***: The target's "prospects" were not included in the MAC/MAE definition in any acquisitions announced in 2016, representing a sharp decline from 10% of the acquisitions announced in 2004.

— ***Fiduciary Exception to "No-Shop/No-Talk" Covenant***: The fiduciary exception in 97% of acquisitions announced in 2016 was based on the concept of "an acquisition proposal reasonably expected to result in a superior offer" (up from 79% in 2004), while the standard based on the mere existence of any "acquisition proposal" was present in 3% of acquisitions announced in 2016 (down from 10% in 2004). The standard based on an actual "superior offer" fell from 11% in 2004 to just 1% in 2016. In practice, these trends have been partly offset by an increase in "back-door" fiduciary exceptions, such as the "whenever fiduciary duties require" standard.

— ***"Go-Shop" Provisions***: "Go-shop" provisions, granting the target a specified period of time to seek a better deal after signing an acquisition agreement, appeared in 2% of acquisitions announced in 2016 (similar to the 3% of acquisitions announced in 2007, but down from 11% in 2013).

— ***Appraisal Rights Closing Condition***: The frequency of an appraisal rights closing condition has dropped from 13% of cash deals announced in 2005–2006 to 4% of cash deals in 2016. Among cash/stock deals, an appraisal rights closing condition appeared in 11% of acquisitions announced in 2016, less than half the 28% figure in 2005–2006.

In transactions involving *private* company targets:

— ***"10b-5" Representations***: The prevalence of these representations has declined from 59% of acquisitions completed in 2004 to 26% of acquisitions completed in 2016 and the first half of 2017.

— ***Accuracy of Target Representations at Closing***: The MAC/MAE standard for accuracy of the target's representations at closing has gained wider acceptance, appearing in 48% of acquisitions completed in 2016 and the first half of 2017 compared to 37% of acquisitions completed in 2004.

— ***Inclusion of "Prospects" in MAC/MAE Definition***: The target's "prospects" appeared in the MAC/MAE definition in 15% of acquisitions completed in 2016 and the first half of 2017, down from 36% of acquisitions completed in 2006.

— ***Fiduciary Exception to "No-Shop/No-Talk" Covenant***: Fiduciary exceptions were present in 11% of acquisitions completed in 2016 and the first half of 2017, compared to 25% of acquisitions completed in 2008.

— ***Opinion of Target Counsel***: Legal opinions (excluding tax matters) of the target's counsel have plummeted in frequency from 73% of acquisitions completed in 2004 to 7% of acquisitions completed in 2016 and the first half of 2017.

— ***Appraisal Rights Closing Condition***: An appraisal rights closing condition was included in 57% of acquisitions completed in 2016 and the first half of 2017, the same figure as in 2008. ■

EARNOUTS IN LIFE SCIENCES DEALS

Earnout arrangements in acquisitions of privately held life sciences companies are commonplace, but the acquisition agreements often are not publicly available. In September 2017, SRS Acquiom released a study analyzing the earnout arrangements in 102 transactions since 2008 (limited to deals closed for more than one year with significant post-closing earnout experience) and in which it served as shareholder representative. Most of the buyers were public companies. This study provides a glimpse into some of the hidden details of life sciences company earnouts.

Among all deals covered by the study, potential earnouts in biotech/pharmaceutical deals are, on average, more than four times larger than those in medical device, diagnostics and tools/technologies deals, but these earnouts mature more slowly and have been achieved at a lower rate (31% compared to 41%).

In addition, among deals closed between January 2015 and August 2017:

— *Diligence Standards*: 82% of deals include some sort of diligence standard, while the other 18% have no diligence requirement or expressly state it is at buyer's discretion. Among the deals with a diligence standard, 76% (or 62% of all deals) call for the buyer to apply the efforts it customarily uses for its own programs, taking into account all relevant factors, and 22% (or 18% of all deals) include a buyer disclaimer or qualifier regarding what is required under the applicable diligence standard. Also, 33% of deals include specific diligence requirements instead of, or in addition to, a general diligence standard such as "commercially reasonable efforts."

— *Reporting*: 15% of deals require alliance-like reporting and meeting procedures between buyer and seller representatives.

— *Change of Control*: In the event the buyer is subsequently acquired or transfers the earnout assets to a third party, 43% of deals contain special terms requiring, for example, acceleration or prepayment of earnout payments, or for the original buyer to guarantee the subsequent buyer's performance.

— *Transfer of Earnout Rights*: 13% of deals expressly permit sellers to transfer their rights to receive earnout payments, under certain circumstances.

— *Dispute Resolution*: 30% of deals require ADR to resolve earnout disputes.

Trends in VC-Backed Company M&A Deal Terms

We reviewed all merger transactions between 2010 and 2017 involving venture-backed targets (as reported in Dow Jones VentureSource) in which the merger documentation was publicly available and the deal value was $25 million or more. Based on this review, we have compiled the following deal data:

Characteristics of Deals Reviewed		2010	2011	2012	2013	2014	2015	2016	2017
The number of deals we reviewed and the type of consideration paid in each	Sample Size	17	51	26	27	37	27	19	18
	Cash	71%	73%	73%	59%	59%	67%	47%	56%
	Stock	6%	4%	8%	8%	3%	4%	0%	0%
	Cash and Stock	23%	23%	19%	33%	38%	29%	53%	44%
Deals with Earnout		**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Deals that provided contingent consideration based upon post-closing performance of the target (other than balance sheet adjustments)	With Earnout	29%	29%	31%	33%	30%	26%	37%	22%
	Without Earnout	71%	71%	69%	67%	70%	74%	63%	78%
Deals with Indemnification		**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Deals where the target's shareholders or the buyer indemnified the other post-closing for breaches of representations, warranties and covenants	With Indemnification								
	By Target's Shareholders	100%	98%	100%	100%	97%	100%	100%[1]	94%[2]
	By Buyer	17%	43%	62%	44%	49%	69%	37%	61%
Survival of Representations and Warranties		**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Length of time that representations and warranties survived the closing for indemnification purposes[3]	Shortest	9 Mos.	12 Mos.	10 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.	9 Mos.
	Longest	21 Mos.	24 Mos.	24 Mos.	30 Mos.	24 Mos.	24 Mos.	18 Mos.	24 Mos.
	Most Frequent	18 Mos.	18 Mos.	18 Mos.	18 Mos.	12 & 18 Mos. (tie)	18 Mos.	18 Mos.	12 Mos.
Caps on Indemnification Obligations		**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Upper limits on indemnification obligations where representations and warranties survived the closing for indemnification purposes	With Cap	100%	100%	100%	100%	100%	100%	100%	100%
	Limited to Escrow	71%	77%	81%	88%	89%	79%	83%	94%[5]
	Limited to Purchase Price	6%	2%	0%	0%	0%	0%	0%	0%
	Exceptions to Limits[4]	94%	96%	96%	100%	100%	100%	95%	94.1%
	Without Cap	0%	0%	0%	0%	0%	0%	0%	0.1%

[1] Includes one transaction where the only representations that survive for purposes of indemnification are certain "fundamental" representations and representations concerning material contracts and intellectual property.

[2] Includes one transaction where the only representations that survive for purposes of indemnification are those concerning capitalization, financial statements and undisclosed liabilities, but excludes one transaction where indemnification was provided for breaches of covenants prior to the closing but representations did not survive for purposes of indemnification.

[3] Measured for representations and warranties generally; specified representations and warranties may survive longer. Excludes one transaction in each of 2011 and 2014 where general representations and warranties did not survive.

[4] Generally, exceptions were for fraud, willful misrepresentation and certain "fundamental" representations commonly including capitalization, authority and validity. In a limited number of transactions, exceptions also included intellectual property representations.

[5] Includes two transactions where the limit was below the escrow amount.

Escrows		2010	2011	2012	2013	2014	2015	2016	2017
Deals having escrows securing indemnification obligations of the target's shareholders	With Escrow	100%	94%	100%	93%[6]	97%	93%	89%	94%
	% of Deal Value								
	Lowest[7]	2%	5%	5%	5%	2%	4%	5%	4%
	Highest	25%	31%	16%	20%	16%	16%	15%	13%
	Most Frequent	10%	10%	10%	10%	10%	10%	10%	5%
	Length of Time								
	Shortest	9 Mos.	12 Mos.	10 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.	9 Mos.
	Longest	36 Mos.	36 Mos.	48 Mos.	30 Mos.	24 Mos.	36 Mos.	24 Mos.	24 Mos.
	Most Frequent	18 Mos.	18 Mos.	12 Mos.	18 Mos.	12 Mos.	12 & 18 Mos. (tie)	18 Mos.	12 & 18 Mos. (tie)
	Exclusive Remedy	53%	78%	73%	60%	86%	63%	88%	71%
	Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy[4]	80%	97%	100%	100%	100%	100%	93%	92%

Baskets for Indemnification		2010	2011	2012	2013	2014	2015	2016	2017
Deals with indemnification only for amounts above a specified "deductible" or only after a specified "threshold" amount is reached	Deductible[8]	56%	38%	27%	50%	44%	31%	47%	63%
	Threshold[8]	44%	60%	65%	42%	56%	61%	53%	37%

MAE Closing Condition		2010	2011	2012	2013	2014	2015	2016	2017
Deals with closing condition for the absence of a "material adverse effect" with respect to the other party, either explicitly or through representation brought down to closing	Condition in Favor of Buyer	100%	98%	95%	100%	97%	100%	100%	94%
	Condition in Favor of Target	19%	15%	9%	17%	19%	12%	39%	22%

Exceptions to MAE		2010	2011	2012	2013	2014	2015	2016	2017
Deals where the definition of "material adverse effect" for the target contained specified exceptions	With Exception[9]	94%	94%[10]	84%[11]	96%[12]	100%	100%	100%	100%

[6] One of two transactions not including an escrow at closing did require funding of escrow with proceeds of earnout payments.

[7] Excludes transactions which also specifically referred to representation and warranty insurance as recourse for the buyer.

[8] A "hybrid" approach with both a deductible and a threshold was used in another 2% of these transactions in 2011, 8% of these transactions in 2012, 8% of these transactions in 2013, and 8% of these transactions in 2015.

[9] Generally, exceptions were for general economic and industry conditions.

[10] Excludes one transaction where the specified exceptions do not apply for purposes of a standalone "material adverse effect" closing condition.

[11] Includes one transaction where the specified exceptions apply for purposes of a standalone "material adverse effect" closing condition and certain representations, but do not apply for purposes of other representations.

[12] The only transaction not including such exceptions provided for a closing on the same day the definitive agreement was signed.

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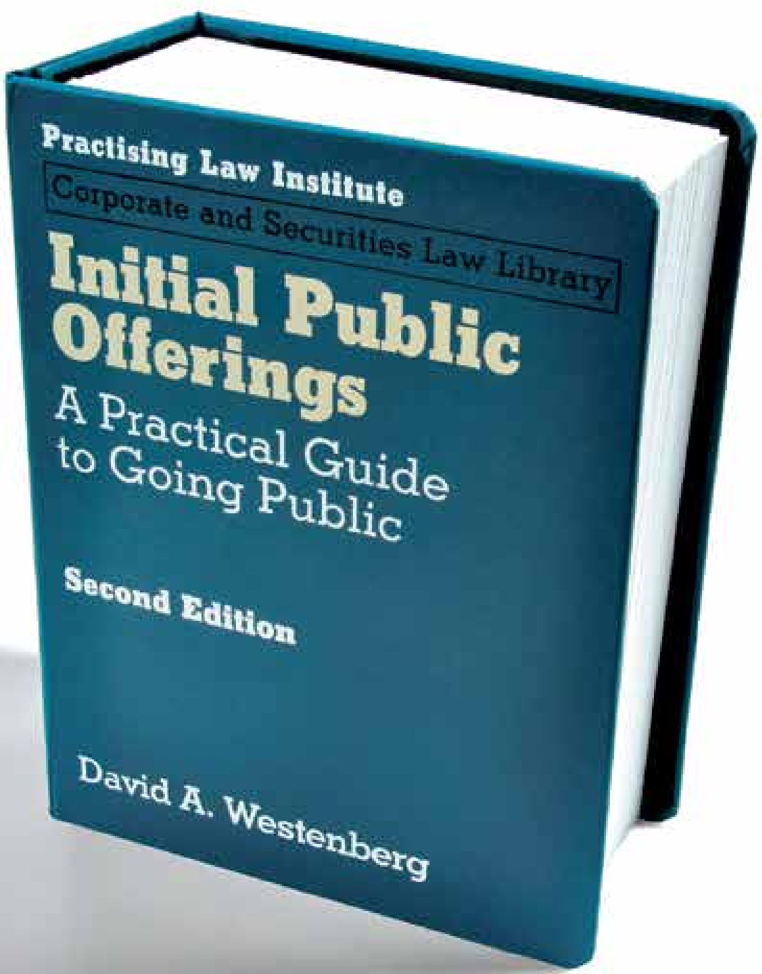

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An electronic copy of this report can be found at wilmerhale.com/2018MAreport.

Data Sources: M&A data is sourced from S&P Global Market Intelligence. WilmerHale compiled the data for sales of VC-backed companies from Dow Jones VentureSource. For law firm rankings, sales of VC-backed companies are included under the current name of each law firm. Other data sources are as indicated in this report.

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