2014 M&A Report

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REVIEW

Global M&A deal volume declined for the second consecutive year in 2013. The total number of reported M&A transactions worldwide contracted 8%, from 28,601 in 2012 to 26,409 in 2013. Global M&A deal volume was unchanged, at $1.87 trillion in both years, after four consecutive years of growth.

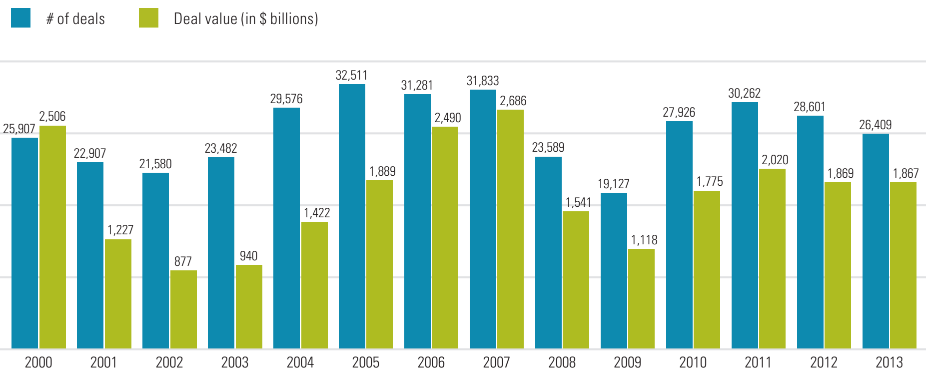
Aggregate global deal volume increased over the last three quarters of 2013, but the fourth quarter tally of 7,053 deals was still 4% below the quarterly average that prevailed in 2011 and 2012.

The number of worldwide billion-dollar transactions decreased 3%, from 353 in 2012 to 342 in 2013. Aggregate global billion-dollar deal value grew 4%, from $1.08 trillion in 2012 to $1.13 trillion in 2013.

Deal volume declined across all geographic regions in 2013, and only the United States showed growth in deal value:

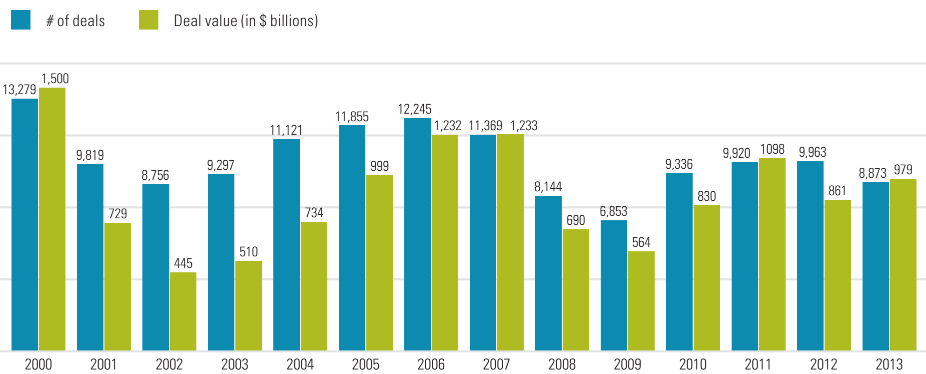
- *United States*: Deal volume in the United States declined 11%, from 9,963 transactions in 2012 to 8,873 in 2013. US deal value, however, posted a 14% increase, from $860.9 billion in 2012 to $979.2 billion in 2013, resulting in a 28% increase in average deal size from $86.4 million to $110.4 million. The number of billion-dollar transactions involving US companies decreased by 9%, from 216 in 2012 to 197 in 2013, while the aggregate value of these transactions grew 22%, from $606.6 billion to $742.2 billion.
- *Europe*: European deal volume and value both declined in 2013. The number of transactions fell 6%, from 11,612 in 2012 to 10,943 in 2013, while deal value dropped 18%, from $785.6 billion to $645.6 billion. The number of billion-dollar transactions involving European companies edged down from 164 in 2012 to 161 in 2013, while their aggregate value declined 6%, from $590.5 billion to $557.1 billion.
- *Asia-Pacific*: The Asia-Pacific region saw deal volume decline 8%, from 8,808 transactions in 2012 to 8,113 in 2013. Aggregate deal value in the region fell 9%, from $497.1 billion in 2012 to $452.1 billion in 2013. Billion-dollar transactions involving Asia-Pacific companies increased 6%, from 83 in 2012 to 88 in 2013, while their aggregate deal value fell 20%, from $247.3 billion to $196.6 billion.

Global M&A Activity – 2000 to 2013



Source: MergerStat

US M&A Activity – 2000 to 2013



Source: MergerStat

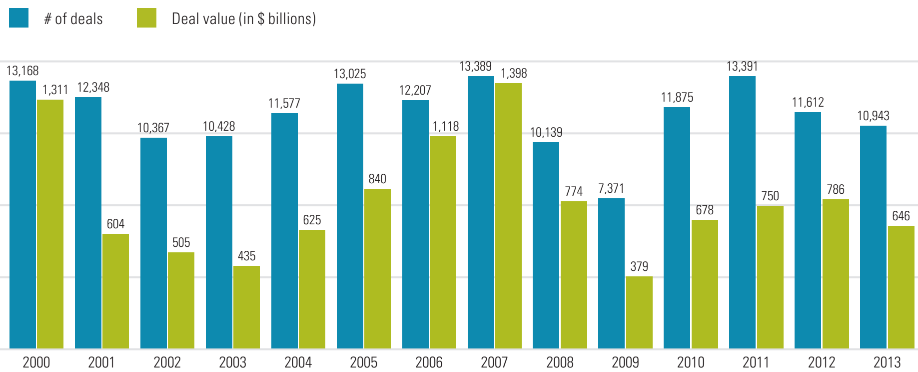
Results varied across principal industry sectors in 2013. The financial services sector turned in a comparatively weak performance, while large transactions fueled strong results in other sectors:

- *Financial Services*: Global transaction volume in the financial services sector dipped 3%, from 1,237 deals in 2012 to 1,200 deals in 2013. Aggregate global financial services deal value fell 30%, from $138.3 billion in 2012 to $96.5 billion in 2013. In the United States, financial services sector deal volume decreased 4%, from 440 in 2012 to 423 in 2013, while deal value fell 37%, from $38.8 billion to $24.6 billion.
- *Technology*: Global transaction volume in the technology sector declined 7%, from 4,104 deals in 2012 to 3,807 deals in 2013, while aggregate global technology deal value increased 21%, from $117.8 billion to $142.5 billion. US technology deal volume declined 14%, from 2,181 in 2012 to 1,877 in 2013. US technology deal value enjoyed a 25% increase, from $82.5 billion to $103.1 billion, with a boost from Dell's $24 billion acquisition by Michael Dell and private equity firm Silver Lake Partners.
- *Telecommunications*: Global transaction volume in the telecommunications sector increased 11%, from 696 deals in 2012 to 775 deals in 2013. Buoyed by one of the largest M&A transactions of all time—the buyout of Vodafone's 45% stake in Verizon Wireless for $124.1 billion—aggregate global telecommunications deal value soared 119%, from $112.0 billion in 2012 to $245.6 billion in 2013. US telecommunications deal volume

fell 10%, from 266 in 2012 to 240 in 2013, but deal value more than tripled from $48.2 billion to $153.0 billion.

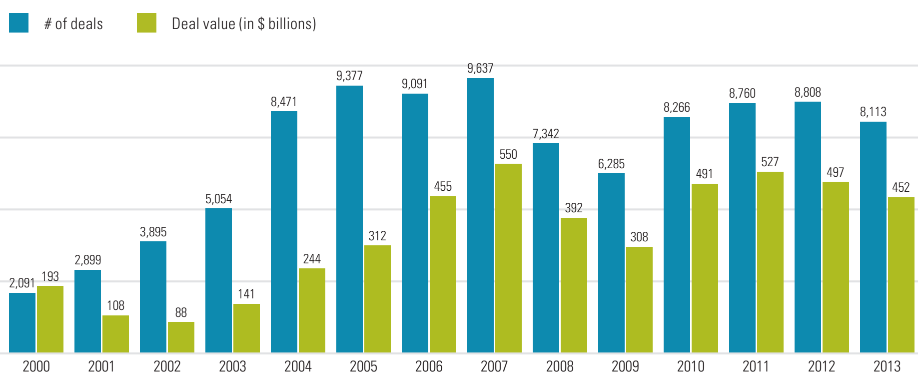
- *Life Sciences*: Global transaction volume in the life sciences sector increased 3%, from 1,046 deals in 2012 to 1,074 deals in 2013. Aggregate global life sciences deal value jumped 39%, from $95.9 billion to $133.8 billion. US life sciences deal volume declined 13%, from 446 in 2012 to 390 in 2013, while deal value increased 40%, from $70.5 billion to $98.7 billion. The largest life sciences M&A transaction of the year was Thermo Fisher Scientific's $13.6 billion acquisition of Life Technologies, followed by the $10.4 billion acquisition of Onyx Pharmaceuticals by Amgen and the $8.7 billion acquisition of Bausch + Lomb by Valeant Pharmaceuticals.
- *VC-Backed Companies*: Unlike the ebullient market for VC-backed IPOs, the M&A market for venture-backed companies contracted for the third consecutive year in 2013. The number of reported acquisitions of VC-backed companies declined by 9%, from 456 in 2012 to 413 in 2013, and total proceeds fell 14%, from $43.0 billion to $36.9 billion.

European M&A Activity – 2000 to 2013



Source: MergerStat

Asia-Pacific M&A Activity – 2000 to 2013



Source: MergerStat

OUTLOOK

M&A activity in 2014 will depend on a number of factors, including the following:

- *Economic Conditions*: While there are lingering concerns about the extent of the global economic recovery, the US Federal Reserve's decision to keep interest rates close to zero substantially lowers the cost of large takeovers funded by debt. For companies facing limited growth opportunities, acquisitions are a natural avenue to bolster market share, build out brands and pursue longer-term strategic initiatives.
- *Private Equity Impact*: Private equity will remain a key component of the M&A market in 2014. On the sell side, private equity firms continue to dispose of companies acquired during the pre-crisis buyout boom as debt obligations become due. On the buy side, "dry powder" (unspent capital that investors have committed to provide for investing over a period of time) remains at near-record levels and private equity firms are facing pressure to deploy vast sums before investment periods expire. The result is likely to be ferocious competition for attractive deals and rising valuations in the coming year.
- *Venture Capital Pipeline*: The venture capital pipeline is brimming with acquisition targets. While the JOBS Act was designed to streamline the IPO process and lighten the burden of being public for companies that qualify as "emerging growth companies" (EGCs), many venture-backed companies and their investors still prefer the relative ease and certainty of being acquired to the lengthier and more uncertain IPO process. For established companies grappling with the emergence of disruptive innovations, technology companies will remain attractive targets. The first quarter of 2014 has already produced six VC-backed company acquisitions for more than $1 billion, led by Facebook's proposed acquisition of WhatsApp for $19 billion—the most ever paid for a venture-backed company— and Google's $3.2 billion acquisition of Nest, compared to a total of seven billion-dollar-plus acquisitions in all of 2013.
- *Intellectual Property Motivations*: With increased patent litigation costs, some M&A activity is also likely to be prompted by a desire to shore up patent portfolios to block or counter potential patent litigation.

Economic challenges remain, but the above factors encourage favorable expectations for the M&A market over the coming year. Notable deal announcements in the first quarter of 2014 include the proposed $45.2 billion merger of Time Warner Cable and Comcast, and Actavis's pending acquisition of Forest Laboratories for $25 billion. ■

EXON-FLORIO OVERVIEW

The Hart-Scott-Rodino Antitrust Improvements Act (HSR Act) requires that proposed acquisitions meeting specified size thresholds be reported to the federal antitrust authorities prior to consummation. HSR compliance is a well-known and routine step in many M&A transactions. If a US company is being acquired by a foreign acquirer, however, consideration must also be given to the Exon-Florio law, enacted in 1988.

Under Exon-Florio, the President is authorized to investigate the impact on US national security of acquisitions by foreign persons that result in foreign control of a US business. The Committee on Foreign Investment in the United States (CFIUS), a multi-agency regulatory body, is charged with reviewing the national security implications of foreign investments in the United States. Unless a party to the transaction voluntarily seeks pre-closing CFIUS review, there is no time limit on the President's authority to investigate a completed transaction. Exon-Florio provides that actions and findings of the President are not subject to judicial review.

Formal presidential orders prohibiting transactions or requiring parties to unwind transactions that have already occurred are extremely rare. In September 2012, President Obama issued an order prohibiting Ralls Corporation, an affiliate of the Chinese machinery manufacturer Sany Group, from acquiring four US wind farm project companies because the President found "credible evidence" to believe that parties to the transaction "might take action that threatens to impair the national security of the United States." The President's order required the buyer, under the supervision of CFIUS, to divest all interests in the acquired companies within 90 days. Prior to the Ralls action, the last order of this type was issued by President George H.W. Bush in 1990.

The specter of CFIUS concerns can deter transactions even in the absence of formal presidential orders. In 2011, for example, Huawei withdraw its voluntary pre-closing filing prior to a presidential decision after encountering national security objections from CFIUS in connection with a planned acquisition of 3Leaf Systems, a technology company that developed virtualization solutions for enterprise data centers.

CFIUS REVIEW PROCESS

A voluntary notice that results in CFIUS clearance grants the transaction a safe harbor from post-closing review and challenge. The CFIUS review process requires no filing fee and imposes no mandatory pre-closing waiting period, although parties to a CFIUS review or investigation typically wait until the process is complete before closing. The process begins with an initial 30-day review of the transaction, followed by an additional 45-day investigation if needed. CFIUS has broad discretion to determine whether a 45-day investigation is needed, but an extended review is more likely when the transaction would result in foreign control of critical infrastructure, such as telecommunications, transportation and energy assets. After the 45-day investigation, if further review by the President is recommended by CFIUS, the President has 15 days to permit or deny the acquisition, or to order divestiture if the transaction has been completed.

The overwhelming majority of CFIUS-reviewed transactions are cleared without significant difficulty. In 2012 (the most recent year for which data is available), CFIUS reviewed 114 transactions. In two cases the parties withdrew their filing during the initial 30-day review period and in another 20 cases the parties withdrew their filing after commencement of an investigation. In 12 of these 22 cases, the parties re-filed with CFIUS and CFIUS completed its review of the proposed transaction without objection.

The overall withdrawal rate of 19% of reviewed transactions in 2012 was almost twice the rate that prevailed between 2008 and 2011, likely reflecting the increasingly rigorous nature of the CFIUS review process, in addition to a greater level of foreign investment in sensitive areas of the US economy. When a filing is withdrawn and not re-filed with CFIUS, CFIUS does not disclose if a transaction was abandoned for national security reasons or unrelated reasons.

DEAL IMPLICATIONS

In determining whether voluntarily to seek safe harbor protection by notifying CFIUS of a transaction, the parties must balance the benefit of the safe harbor against the not insignificant costs and burdens of the process, and the risk that notification itself might raise issues that would not otherwise have triggered scrutiny. In this regard:

- The parties should broadly consider possible issues related to national security even if the target business is not directly involved in defense, other national security work or critical infrastructure. The location of a facility or the identity of a buyer can raise national security concerns even if the acquired business is not involved in sensitive technology or activities.
- Even if a formal voluntary filing is not contemplated, the parties should consider discussions with CFIUS prior to closing a transaction that may raise significant national security issues. Although CFIUS is unlikely to provide a party with significant feedback on a transaction without a formal filing, initial contact may provide an opportunity for CFIUS to request further discussions or a formal filing prior to closing a transaction. Without any form of pre-closing communication from the parties, CFIUS may learn of a transaction post-closing and impose conditions that impact the transaction or force divestment.
- CFIUS reviews remain highly fact-dependent, and parties should not automatically assume that foreign acquisitions will encounter difficulties with the US government. As a practical matter, CFIUS has often shown particular interest in transactions when the target US company has export-controlled technologies, classified contracts with the US government or technologies critical to national defense, or when CFIUS member agencies have specific "derogatory intelligence" about the foreign purchaser. CFIUS's attention may also be drawn to a transaction that will result in an absence of US-controlled companies that supply technology or products deemed important to US security. Careful planning and structuring of a transaction involving a sensitive national security issue can reduce the chances of a transaction encountering difficulty during the CFIUS review process. ■

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 hundreds of millions 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 describes pre-acquisition due diligence and post-acquisition integration as among the hallmarks of an effective compliance program. More recently, the now-former leader of the DOJ's FCPA unit explained that the nature and quality of pre-acquisition diligence is one of the most critical factors that the DOJ considers when making a charging decision in the M&A context. 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.

The FCPA risks for purchasers in M&A transactions generally are threefold, any of which may expose the purchaser 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 five areas: 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.
- *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 perhaps 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 may wish to disclose FCPA issues to the DOJ and SEC, even 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. ■

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, 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"?

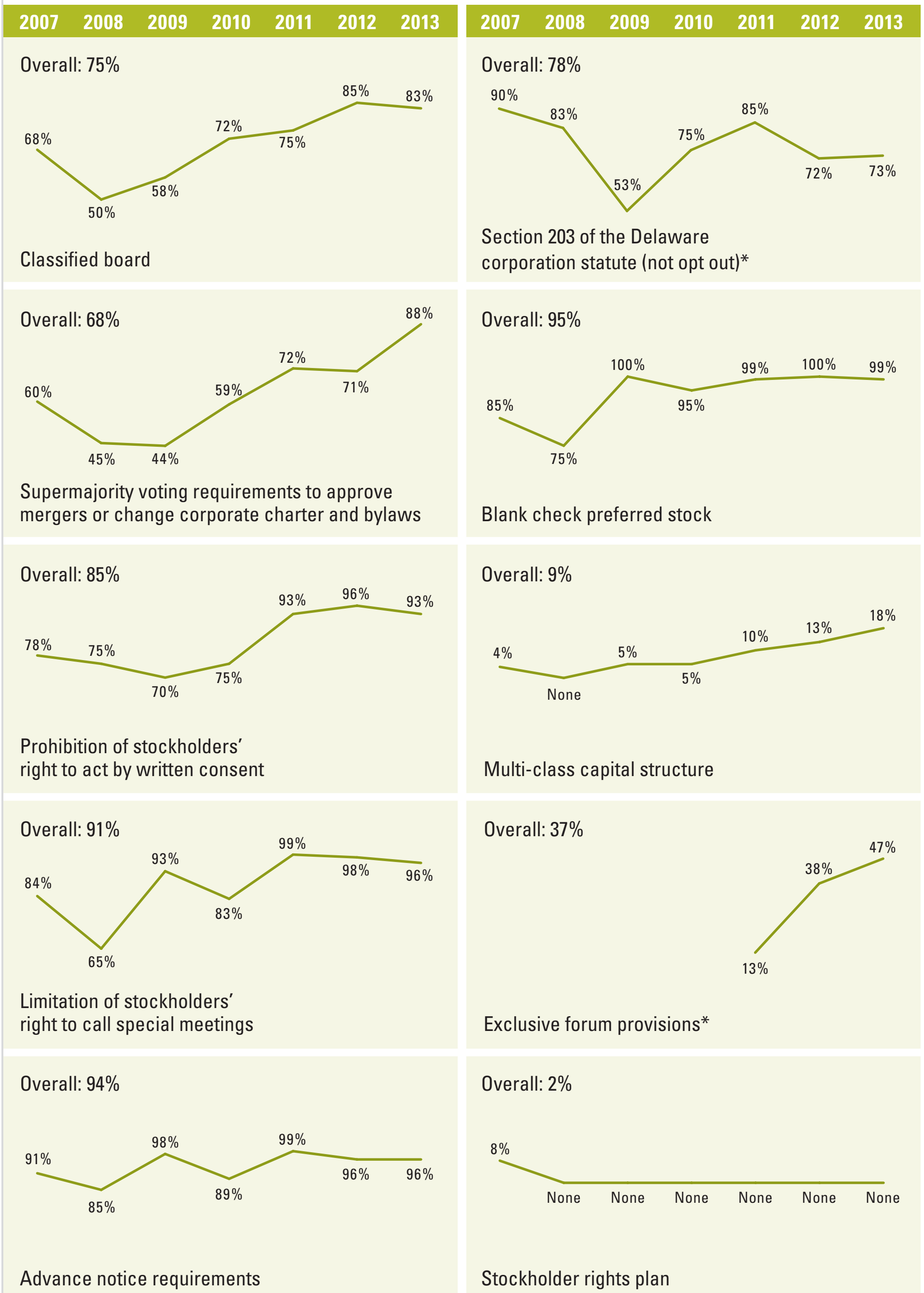
Advocates for supermajority vote requirements claim that these provisions help preserve and maximize the value of the company for all stockholders by ensuring that important protective provisions are eliminated only when it is the clear will of the stockholders. Opponents, however, believe that majority-vote 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

Data sources: IPO company data is based on WilmerHale analysis of SEC filings from 2007 to 2013 (2011–2013 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	ESTABLISHED PUBLIC COMPANIES RUSSELL 3000
Classified board	75%	11%	43%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	68%	22% to 43%, dependng on type of action	20% to 56%, dependng on type of action
Prohibition of stockholders' right to act by written consent	85%	70%	72%
Limitation of stockholders' right to call special meetings	91%	44%	51%
Advance notice provisions	94%	96%	93%
Section 203 of the Delaware corporation statute (not opt out)*	78%	96%	91%
Blank check preferred stock	95%	95%	94%
Multi-class capital structure	9%	9%	10%
Exclusive forum provisions*	37%	15%	16%
Stockholder rights plan	2%	7%	11%

**Delaware corporations only*

Data sources: *IPO company data is based on WilmerHale analysis of SEC filings from 2007 to 2013 (2011–2013 only for exclusive forum provisions) for US issuers. Established public company data is from SharkRepellent.net.*

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 93% 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. Opting out of Section 203 helps eliminate the ability of an insurgent to accumulate and/or exercise control without paying a reasonable 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

Prevalence of Takeover Defenses Among Types of IPO Companies

	ALL IPO COMPANIES	VC-BACKED COMPANIES	PE-BACKED COMPANIES	OTHER IPO COMPANIES
Classified board	75%	85%	75%	50%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	68%	76%	72%	43%
Prohibition of stockholders' right to act by written consent	85%	91%	87%	69%
Limitation of stockholders' right to call special meetings	91%	95%	95%	77%
Advance notice provisions	94%	97%	96%	86%
Section 203 of the Delaware corporation statute (not opt out)*	78%	96%	45%	75%
Blank check preferred stock	95%	97%	98%	87%
Multi-class capital structure	9%	7%	9%	16%
Exclusive forum provisions*	37%	31%	53%	26%
Stockholder rights plan	2%	3%	1%	2%

*Delaware corporations only

Data sources: *IPO company data is based on WilmerHale analysis of SEC filings from 2007 to 2013 (2011–2013 only for exclusive forum provisions) for US issuers. Venture capital–backed IPOs were identified by Dow Jones VentureSource and private equity–backed IPOs were identified by Thomson Reuters.*

shares of preferred stock in one or more 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. Use of a multi-class capital structure facilitates the ability of the holders of the high-vote class of common 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 stipulate in its corporate charter or bylaws that the Court of Chancery of the State of Delaware is the exclusive forum in which it and its directors may be sued by stockholders?

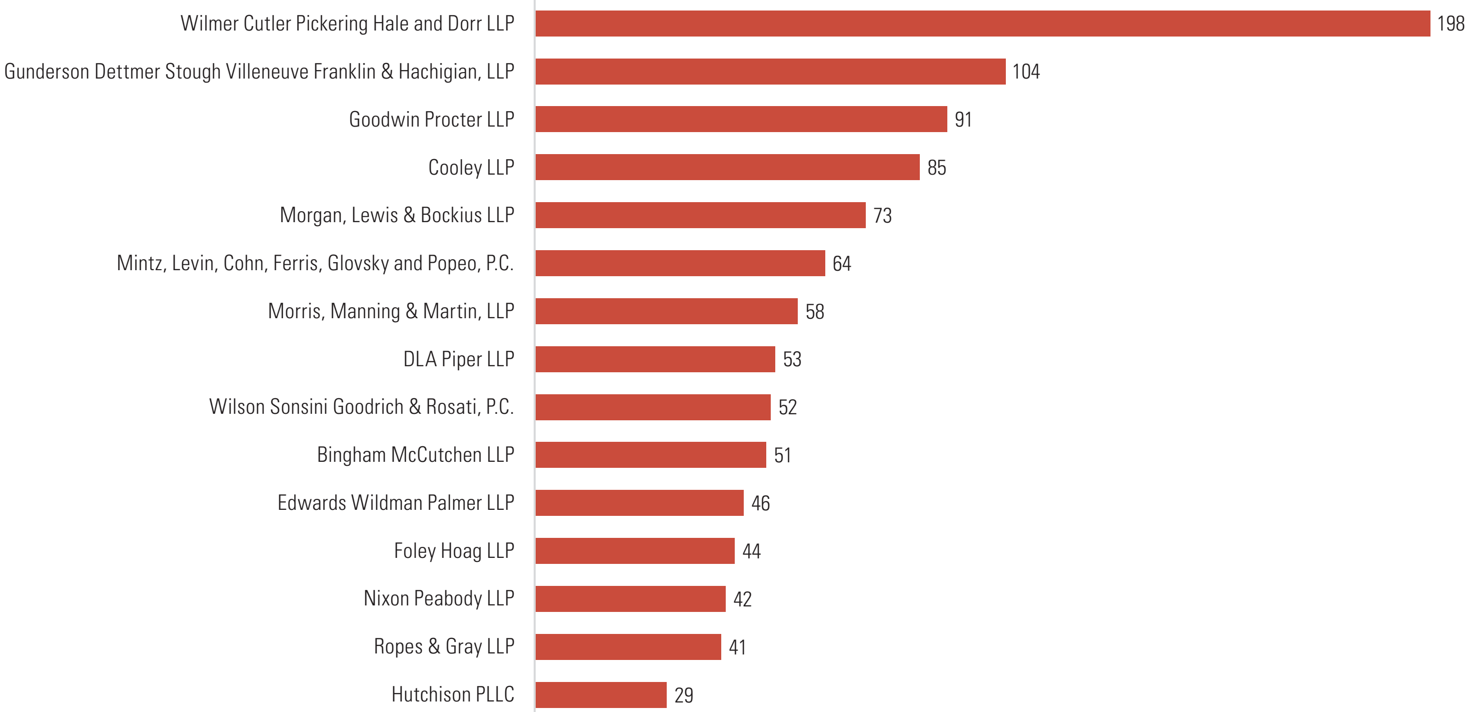
Following a March 2010 decision by the Delaware Court of Chancery, numerous Delaware corporations have included provisions in their corporate charter or bylaws to the effect that the Court of Chancery of the State of Delaware is the exclusive forum in which the company and its directors may be sued by stockholders. Proponents of exclusive forum provisions are motivated by a desire to adjudicate 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?

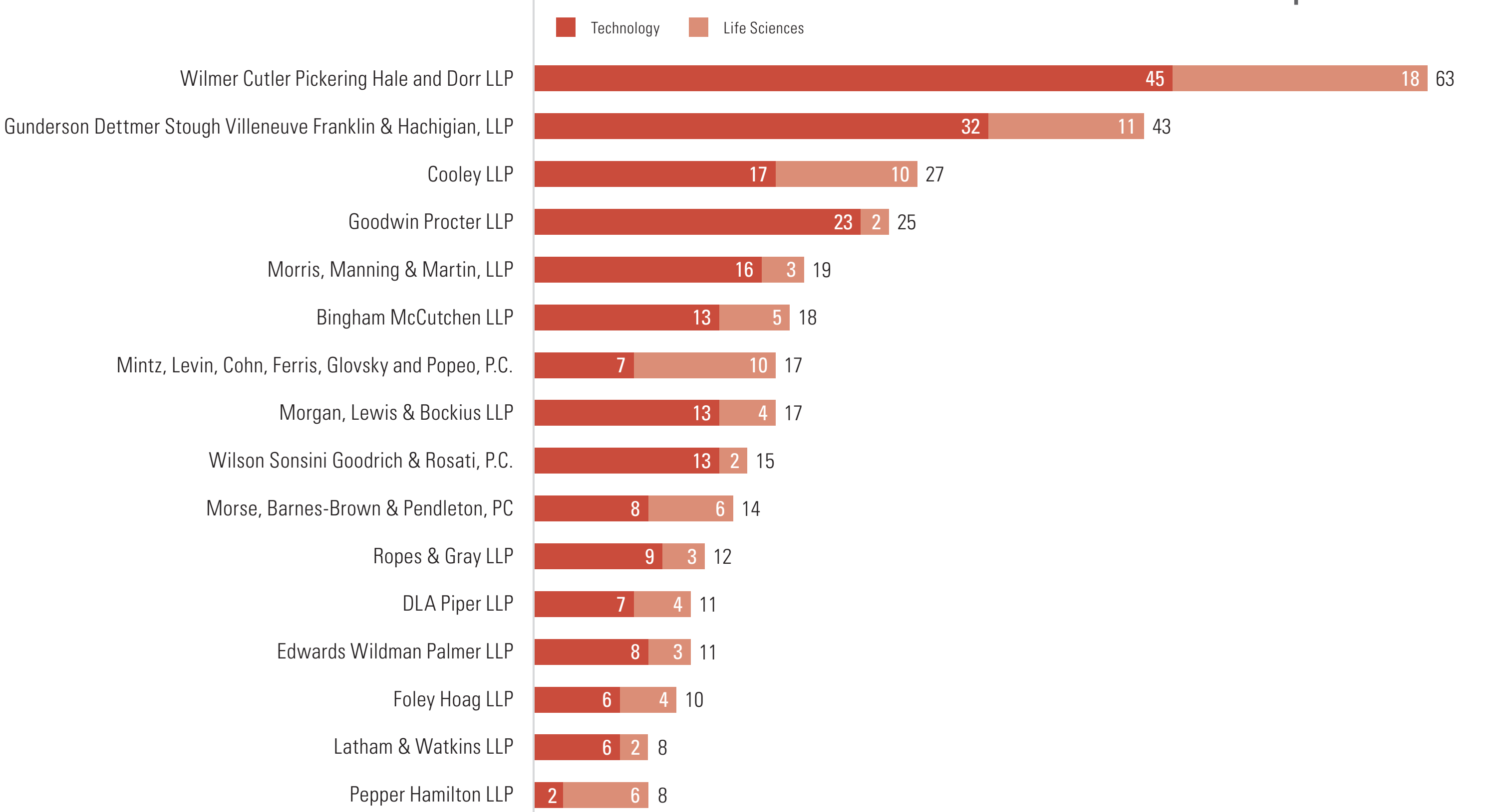
A stockholder rights plan (often referred to as a "poison pill") is a contractual right that allows all stockholders—other than those who acquire more than a specified percentage of the company's stock—to purchase additional securities of the company at a discounted price if a stockholder accumulates 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. ■

Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2013



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 2013



The above chart is based on VC-backed technology and life sciences 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, ENERGY AND CLEANTECH, FINANCIAL SERVICES, DEFENSE, COMMUNICATIONS AND BEYOND

Thermo Fisher Scientific	*Sale of cell culture, gene modulation and magnetic beads businesses to*	GE Healthcare	$1,060,000,000	March 2014
analogic	*Acquisition of*	Ultrasonix Medical	$83,000,000	March 2013
demandware	*Acquisition of*	Mainstreet Commerce	Undisclosed	January 2014
The Medicines Company	*Acquisition of*	Rempex Pharmaceuticals	$474,000,000 (including milestone payments)	December 2013
Bottomline Technologies	*Acquisition of*	Andera	$45,000,000	April 2014
TransUnion	*Acquisition of*	TLO	$154,000,000	December 2013
Akamai	*Acquisition of*	Prolexic Technologies	$403,000,000	February 2014
Analog Devices	*Sale of microphone product line assets to*	InvenSense	$100,000,000	October 2013
Sonus	*Acquisition of*	Performance Technologies	$50,000,000	February 2014
munchkin	*Acquisition of*	BRICA	Undisclosed	January 2014
Brooks	*Acquisition of*	Crossing Automation	$63,000,000	October 2012
Direct Edge	*Acquisition by*	BATS Global Markets	Undisclosed	January 2014
redhat	*Acquisition of*	ManageIQ	$104,000,000	December 2012
LTX-Credence	*Acquisition of the Multitest and ECT businesses of*	Dover Corporation	$93,500,000	December 2013
SallieMae	*Sale of Campus Solutions business to*	Higher One	$47,250,000	May 2013
Empirix	*Acquisition by*	Thoma Bravo	Undisclosed	November 2013
MicroStrategy	*Sale of Angel.com to*	Genesys Telecommunications	$111,000,000	March 2013
Kronos	*Acquisition of*	Smart Computer Holdings	Undisclosed	April 2012
Parexel	*Acquisition of*	Liquent	$72,000,000	December 2012
Natural Motion	*Acquisition by*	Zynga	$527,000,000	February 2014
enobia pharma	*Acquisition by*	Alexion Pharmaceuticals	$1,080,000,000 (including milestone payments)	February 2012
wex	*Acquisition of*	FleetOne Holdings	$369,000,000	October 2012
SS&C	*Acquisition of*	GlobeOp Financial Services	$900,000,000	July 2012
Progress	*Sale of Apama® complex event processing solution to*	Software AG	Undisclosed	July 2013
Endurance International Group	*Acquisition of*	Directi	$102,000,000	January 2014
Ameresco	*Acquisition of*	ESP	Undisclosed	June 2013
Litle & Co	*Acquisition by*	Vantiv	$361,000,000	November 2012
Palomar	*Acquisition by*	Cynosure	$294,000,000	June 2013
Locu	*Acquisition by*	GoDaddy	Undisclosed	August 2013
Kiva Systems	*Acquisition by*	Amazon.com	$775,000,000	May 2012
Booz | Allen | Hamilton	*Acquisition of the Defense Systems Engineering & Support division of*	ARINC	$154,000,000	November 2012
Yandex	*Acquisition of*	KinoPoisk	$80,000,000	October 2013

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The basic financial statement requirements for a company going public are well known. No sensible company would embark on the IPO process if it did not believe that it could satisfy these obligations. Less familiar to many IPO candidates—and sometimes the cause of unpleasant surprises for unsuspecting companies—is the possible need for additional financial statements and pro forma financial information in circumstances involving significant acquisitions, dispositions and equity investments. These additional requirements, which are described below, are imposed by SEC rules and are not required by GAAP.

Significance Tests for Acquisition Financials

The significance tests for acquisition financials are based on the definition of a "significant subsidiary" under Rule 1-02(w) of Regulation S-X, as follows:

- *Investment Test*: The investments in and advances to the target by the company and its consolidated subsidiaries exceed 20% of the total assets of the company and its consolidated subsidiaries as of the end of the most recently completed fiscal year.
- *Asset Test*: The proportionate share of the company and its consolidated subsidiaries of the total assets (after intercompany eliminations) of the target exceeds 20% of the total assets of the company and its consolidated subsidiaries as of the end of the most recently completed fiscal year.
- *Income Test*: The equity of the company and its consolidated subsidiaries in the target's income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle exceeds 20% of such income of the company and its consolidated subsidiaries for the most recently completed fiscal year.

SIGNIFICANT ACQUISITIONS

General Requirements

Significance Tests. Subject to the limited exceptions described below and based on the application of three significance tests, Rule 3-05 of Regulation S-X requires separate financial statements for a significant "business" that is acquired by a company during the periods presented in its Form S-1 registration statement. Separate financial statements for a business whose acquisition is "probable" but not yet completed are also required if the proposed acquisition meets—at the 50% level—any of the three significance tests for acquisition financials.

Definition of "Business." Rule 11-01(d) of Regulation S-X provides that the term "business" should be evaluated in light of the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's operations prior to and after the acquisition to make disclosure of prior financial information material to an understanding of future operations. A presumption exists that a separate entity, subsidiary or division is a business, but a lesser component of an entity may also constitute a business.

Among the facts and circumstances that should be considered in evaluating whether a lesser component of an entity constitutes a business are whether the nature of the revenue-producing activity of the component will remain generally the same as before the acquisition, and whether any of the following attributes remain with the component after the acquisition: physical facilities, employee base, market distribution system, sales force, customer base, operating rights, production techniques or trade names. In practice, the term "business" is interpreted broadly, and most acquisitions meeting the applicable significance tests trigger the requirement for separate financial statements.

Definition of "Probable." Regulation S-X does not define the word "probable." In general, a proposed acquisition will not be considered probable if a definitive agreement has not been signed, and a proposed acquisition will be considered probable if a definitive agreement has been signed and closing is subject only to normal closing conditions. Even if a potential transaction is not probable and thus does not require separate financial statements under Rule 3-05, some disclosure about the transaction may be required in the Form S-1 to satisfy general antifraud requirements, or if a portion of the IPO proceeds will be used to finance the acquisition.

Treatment of Related Businesses. Regulation S-X treats completed or probable acquisitions of "related" businesses as a single transaction for the purposes of determining whether financial statements are required to be included and, if so, which financial statements are needed. For this purpose, businesses are deemed to be related if they are under common control or management; the acquisition of one business is conditioned on the acquisition of the other business; or each acquisition is conditioned on a single common event.

Required Periods. Depending on the significance of the business whose acquisition is completed or probable, the company may be required to include separate financial statements of the business for up to three fiscal years plus any subsequent interim period (and the comparative prior interim period), as well as pro forma financial information presenting the combination of the company and the acquired business for the most recent fiscal year and any subsequent interim period (but not the comparative prior interim period). The periods for which separate financial statements are required are determined by reference to the significance tests for acquisition financials.

In some circumstances, Rule 3-06 of Regulation S-X permits audited financial statements of an acquired business (but not of the registrant) covering a period of nine to twelve months to satisfy the requirement of financial statements for a period of one year. In addition, in an IPO registration statement, an acquirer may apply the period of time in which the operations of an acquired business are included in the audited income statement of the acquirer to reduce the number of periods for which pre-acquisition income statements are required, if there is no gap between the audited pre-acquisition and audited post-acquisition periods.

Standards for Separate Financial Statements. If required, the separate financial statements generally must meet the standards applicable to the company's own financial statements, except:

- to the extent that accounting standards provide for non–public company exceptions (such as those related to segment reporting and earnings-per-share calculations); and
- the auditor need not be registered with the PCAOB and need not satisfy SEC and PCAOB independence rules with respect to the company, unless the business whose acquisition has been completed or become probable is deemed to be a predecessor of the company.

Pro Forma Financial Information. In addition to the separate financial statements described above, Rule 11-01 of Regulation S-X requires the inclusion of pro forma financial information—presenting the combination of the company and the acquired business after giving effect to purchase adjustments—that meets the requirements of Rule 11-02 if:

- during the company's most recent fiscal year or subsequent interim period for which a balance sheet is required, a significant business combination (at the 20% level of significance) has been completed;
- after the date of the company's most recent balance sheet, a significant business combination (at the 20% level of significance) has been completed or become probable;
- the company previously was a part of another entity and such presentation is necessary to reflect the operations and financial position of the company as an autonomous entity; or
- consummation of other events or transactions has occurred or is probable for which disclosure of pro forma financial information would be material to investors.

The required pro forma information generally consists of a condensed balance sheet as of the end of the most recent period for which a consolidated balance sheet of the company is required in the Form S-1, and condensed statements of income for the company's most recent fiscal year and any subsequent interim period. The company may elect to include a pro forma condensed statement of income for the corresponding interim period of the preceding fiscal year, but ordinarily does not unless doing so would be helpful to explain some aspect of the combined company's business, such as seasonality.

Periods for which Acquisition Financials Are Required

SIGNIFICANCE TESTS	STATUS OF ACQUISITION	PERIODS REQUIRED
If all ≤ 20%	Completed or probable	None (unless aggregate impact of individually insignificant businesses acquired since the date of most recent audited balance sheet exceeds 50%)
If any > 20% and all ≤ 40%	Completed only	One year audited plus unaudited interim periods
If any > 40% and all ≤ 50%	Completed only	Two years audited plus unaudited interim periods
If any > 50%	Completed or probable	Three years audited (two years audited, if the acquirer is an EGC and is presenting only two years of audited financial statements in its IPO registration statement, and two years audited for any target company with less than $50 million in net revenues in its most recent fiscal year) plus unaudited interim periods

When more than one acquisition has been completed or become probable during a fiscal year, the cumulative effect of the acquisitions must be assessed to determine whether pro forma financial information is required. If the cumulative effect of the acquisitions exceeds 50% for any of the significance tests described above, pro forma financial information must be presented for the required periods based on the cumulative magnitude of the significance test.

Potential Complications. Satisfaction of the acquisition financial statement requirements of Regulation S-X can be challenging when the target business is a division, business unit or collection of assets that does not have separate financial statements and was never separately audited. When an acquisition is probable but not completed, additional complications can arise if separate financial statements do not exist and the company does not have a contractual right to conduct an audit. The requirements of Regulation S-X can be especially problematic if an acquired business is in a foreign jurisdiction in which accounting practices do not enable the preparation of financial statements that can be audited for SEC purposes.

Exceptions

Several exceptions to the acquisition financial statement requirements described above provide some relief.

- *Recent Acquisitions*: Separate financial statements and pro forma financial information are not required to be included in the Form S-1 for acquisitions completed within 74 days before the date of the final prospectus, if none of the significance tests are met at the 50% level and the omitted financial statements and pro forma financial information are filed on a Form 8-K no later than 75 days after completion of the acquisition. The purpose of this exception is to allow IPO companies, in most circumstances, to provide information about significant acquisitions on the same basis as existing public companies are required under the Exchange Act.

- *Roll-Up Companies*: Staff Accounting Bulletin No. 80 provides that, in the case of IPOs by businesses that have been built by the aggregation of discrete businesses that remain substantially intact after acquisition, the company may assess the significance of an acquisition based on the company's consolidated financial statements at the time of the initial Form S-1 filing (or confidential submission, if applicable) rather than at the time of the acquisition.

SIGNIFICANT DISPOSITIONS

Rule 11-01 of Regulation S-X requires a company to present pro forma financial information if its disposition of a significant portion of a business—whether by sale, abandonment or distribution to stockholders by means of a spin-off, split-up or split-off—has occurred or is probable and such disposition is not fully reflected in the financial statements of the company included in the Form S-1. For this purpose, the disposition of "a significant portion of a business" means the disposition of a significant subsidiary, as defined above, except that the percentage changes from 20% to 10% for each test of significance.

Rule 11-02 provides that a company must prepare pro forma financial information for a disposition by beginning with the historical financial statements of the existing entity and showing the deletion of the business being divested, along with the pro forma adjustments necessary to arrive at the remainder of the existing entity. For example, pro forma adjustments would include adjustments of interest expense arising from a revised debt structure, and removal of expenses that have been incurred on behalf of the business being divested.

The periods for which pro forma financial information for significant dispositions must be presented are generally the same as the required periods for significant acquisitions. In the case of discontinued operations that are not yet required to be reflected in historical statements, however, three years of pro forma income statements and comparative interim periods are required. In the case of an emerging growth company (EGC) that is presenting only two years of audited financial statements in its IPO registration statement, this period is shortened to two years.

Separate financial statements for a business whose disposition has occurred or is probable are not required to be presented in the Form S-1. The pro forma financial information described above will suffice.

SIGNIFICANT EQUITY INVESTMENTS

The company's equity investments also may trigger the need for separate financial statements. If either the investment test or the income test is met at the 20% level by a 50% or less owned entity and the company accounts for the investment by the equity method, Rule 3-09 of Regulation S-X requires separate financial statements of such entity. This means, for example, that the company may be required to provide separate financial statements for entities in which it holds equity investments, or for joint ventures.

If the applicable significance tests are met, the requirement for separate financial statements can even extend to equity investments or joint ventures that existed at any point during the previous three years but have since been divested. While all three years are required to be presented once significance is reached, only the years for which significance is greater than 20% are required to be audited. In the case of an EGC that is presenting only two years of audited financial statements in its IPO registration statement, the foregoing periods are shortened to two years.

RELIEF FROM FINANCIAL STATEMENT REQUIREMENTS

Relief may be sought from the SEC to permit the omission of any financial statements required by Regulation S-X or the substitution of "appropriate statements of comparable character." Rule 3-13 requires that the relief be "consistent with the protection of investors."

The process of seeking relief can be time-consuming and its outcome uncertain. The company will stand the best chance of success if it can demonstrate that the required financial statements cannot be obtained and that any substituted financial information will provide all material financial information needed by investors. The company can bolster its case by demonstrating that satisfaction of the requirement would involve "unreasonable effort or expense"—the general standard contained in Rule 409 under the Securities Act for relief from SEC disclosure requirements.

In theory, these standards for relief sound reasonably attainable; in practice, a company is rarely excused from providing historical or pro forma financial information in connection with an acquisition or disposition transaction, although a request to provide substituted financial information may be granted. For example, in asset acquisitions where the acquired operations are a component of the seller's historical business operations, the seller continues to operate the portion of its business not acquired by the acquirer, the acquired operations have not been accounted for as a separate entity, and separate stand-alone financial statements for the acquired operations have never been prepared, the staff, subject to pre-clearance, regularly permits the inclusion of statements of net assets acquired and liabilities assumed of the acquired operations and statements of revenues and direct expenses of the acquired operations (audited for the prescribed periods), together with the corresponding unaudited pro forma financial information, in lieu of the full financial statements otherwise required by Rule 3-05.

CONCLUSION

If a private company planning to go public has engaged in M&A activity (whether as a buyer or seller), it should review with its auditor whether any additional financial statements will be required as part of its SEC registration process; if so, determine if they are available; and if not, develop a plan to obtain them, which may require auditing or re-auditing the acquired company's financial statements. In some cases, the company may need to consider shelving its M&A plans until the IPO is completed to avoid these 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 usually structured as a merger or a tender offer.
- *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, because the existence of publicly available information means due diligence can begin in advance and all parties share a desire to minimize the period of time during which the news might leak. More time may be required between signing and closing, however, because of the requirement to prepare and circulate a proxy statement for stockholder approval (unless a tender offer structure is used), and the need in many public company acquisitions for antitrust clearances that may not be required in smaller, private company deals.
- *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 is more likely to 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.
- *Closing Conditions*: The closing conditions in the merger agreement, including the "no material adverse change" condition, are generally tightly drafted in public company deals, 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 rare.
- *Earnouts*: Earnouts are unusual, although a form of earnout arrangement called a "contingent value right" is not uncommon in the biotech 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*: 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 possibly reviewed by) the SEC. In addition, the Dodd-Frank Act generally requires public targets that seek stockholder approval to provide for a separate, non-binding stockholder vote with respect to all compensation each named executive officer will receive in connection with the transaction.
- *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-K 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. These studies are not necessarily comparable, as there are differences in the time periods and transactions surveyed in each. The SRS|Acquiom study covers private target acquisitions in which it served as shareholder representative and that closed in 2013. The ABA private target study covers acquisitions that were completed in 2012, and the ABA public target study covers acquisitions that were announced in 2012 (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 Reps at Closing*: The standard against which the accuracy of the target's representations and warranties is measured for purposes of the acquirer's closing conditions:
  - A "MAE/MAC" standard provides that each of the representations and warranties of the target set forth in the acquisition agreement 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 effect/change on the target.*
  - An "in all material respects" standard provides that the representations and warranties of the target set forth in the acquisition agreement 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 set forth in the acquisition agreement must be true and correct *in all respects* as of the closing.
- *Inclusion of "Prospects" in MAE/MAC Definition*: Whether the "material adverse effect/change" 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-Talk" Covenant*: Whether the "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, by-laws 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 MAE/MAC Termination Right*: Whether the acquisition agreement contains a closing condition permitting the acquirer to terminate the agreement if an event or development has occurred that has had, or could reasonably be expected to have, a "material adverse effect/change" on the target.

"10b-5" Representation	
PUBLIC (ABA)	1%
PRIVATE (ABA)	36%
PRIVATE (SRS|ACQUIOM)	48%
Standard for Accuracy of Target Reps at Closing	
PUBLIC (ABA)	
"MAE/MAC"	94%
"In all material respects"	3%
Other standard	3%
PRIVATE (ABA)	
"MAE/MAC"	47%
"In all material respects"	53%
"In all respects"	None
PRIVATE (SRS|ACQUIOM)	
"MAE/MAC"	36%
"In all material respects"	58%
"In all respects"	6%
Inclusion of "Prospects" in MAE/MAC Definition	
PUBLIC (ABA)	1%
PRIVATE (ABA)	17%
PRIVATE (SRS|ACQUIOM)	11%

Fiduciary Exception to "No-Talk" Covenant	
PUBLIC (ABA)	100%
PRIVATE (ABA)	15%
PRIVATE (SRS|ACQUIOM)	6%
Opinion of Target's Counsel as Closing Condition	
PUBLIC (ABA)	–
PRIVATE (ABA)	19%
PRIVATE (SRS|ACQUIOM)	38%
Appraisal Rights Closing Condition	
PUBLIC (ABA)	
All cash deals	6%
Part cash/part stock deals	14%
PRIVATE (ABA)	
All deals	54%
PRIVATE (SRS|ACQUIOM)	
All deals	50%
Acquirer MAE/MAC Termination Right	
PUBLIC (ABA)	97%
PRIVATE (ABA)	94%
PRIVATE (SRS|ACQUIOM)	94%

TRENDS IN SELECTED DEAL TERMS

The ABA deal term studies have been published periodically, beginning with public target acquisitions that were announced in 2004 and private target acquisitions that were completed in 2004. A review of past studies identifies the following trends, although in any particular transaction negotiated outcomes may vary:

In transactions involving *public* company targets:

- *"10b-5" Representations*: These representations have all but disappeared, falling from 19% of acquisitions announced in 2004 to just 1% of acquisitions announced in 2012.
- *Accuracy of Target Reps at Closing*: The MAE/MAC standard for accuracy of the target's representations at closing is now near-universal, present in 94% of acquisitions announced in 2012 compared to 82% of acquisitions announced in 2005–2006. In practice, this trend has been offset to some extent by the use of exceptions with lower standards for specific representations.
- *Inclusion of "Prospects" in MAE/MAC Definition*: The target's "prospects" were included in the MAE/MAC definition in only 1% of acquisitions announced in 2012, following a steady decline in frequency from 10% of acquisitions announced in 2004.
- *Fiduciary Exception to "No-Talk" Covenant*: The fiduciary exception in 98% of acquisitions announced in 2012 was based on the concept of "an acquisition proposal expected to result in a superior offer," up from 79% in 2004. The standard based on an actual "superior offer" declined from 11% in 2004 to just 2% in 2012, while the standard based on the mere existence of any "acquisition proposal," which had been present in 10% of acquisitions announced in 2004, disappeared completely from deals announced in 2012. In practice, this trend has been partly offset by an increase in deals that contain a "back-door" fiduciary exception, such as the "whenever fiduciary duties require" standard.
- *"Go-Shop" Provisions*: The first "go-shop" provisons, granting the target a specified period of time to seek a better deal after signing an acquisition agreement, appeared in 2007, but these provisions were present in only 6% of transactions announced in 2012.
- *Appraisal Rights Closing Condition*: The frequency of an appraisal rights closing condition has dropped from 13% of cash deals announced in 2005–2006 (the first period this metric was surveyed) to 6% of cash deals in 2012, and from 28% of cash/stock deals announced in 2005–2006 to 14% of cash/stock deals in 2012.

In transactions involving *private* company targets:

- *"10b-5" Representations*: The prevalence of these representations has declined from 59% of acquisitions completed in 2004 to 36% of acquisitions completed in 2012.
- *Accuracy of Target Reps at Closing*: The MAE/MAC standard for accuracy of the target's representations at closing has gained wider acceptance, increasing from 37% of acquisitions completed in 2004 to 47% of acquisitions completed in 2012.
- *Inclusion of "Prospects" in MAE/MAC Definition*: The target's "prospects" appeared in the MAE/MAC definition in 17% of acquisitions completed in 2012, down from 36% of acquisitions completed in 2006 (the first year this metric was surveyed).
- *Fiduciary Exception to "No-Talk" Covenant*: Fiduciary exceptions were present in 15% of acquisitions completed in 2012, compared to 25% of acquisitions completed in 2008 (the first year this metric was surveyed).
- *Opinions of Target Counsel*: Legal opinions (excluding tax matters) of the target's counsel have fallen in frequency from 73% of acquisitions completed in 2004 to 19% of acquisitions completed in 2012.
- *Appraisal Rights Closing Condition*: Appraisal rights closing conditions were included in 54% of acquisitions completed in 2012, up from 43% of acquisitions completed in 2008 (the first year this metric was surveyed). ■

Post-Closing Claims

SRS|Acquiom has released a study analyzing post-closing escrow claim activity in 420 private target acquisitions in which it served as shareholder representative from 2007 through the first quarter of 2013. This study provides a glimpse into the hidden world of post-closing escrow claims in private acquisitions:

- *Frequency*: 44% of all transactions had at least one post-closing indemnification claim against the escrow (28% had more than one claim). 91% of all claims that were not withdrawn eventually resulted in some payout.
- *Bases for Claims*: Most common bases for indemnification claims were tax (16% of transactions), intellectual property (11% of transactions), fees/costs (10% of transactions), capitalization (9% of transactions), employee (9% of transactions) and undisclosed liabilities (9% of transactions).
- *Timing*: 18% of all transactions had at least one claim made in the final week of the escrow period. Final escrow releases were delayed in 30% of transactions (an average of seven months) due to pending claims.
- *Litigation/Arbitration*: 12% of all transactions had at least one claim result in litigation or arbitration.
- *Purchase Price Adjustments*: 72% of all transactions with mechanisms for purchase price adjustments had a post-closing adjustment (favorable to the acquirer in 50% of transactions and favorable to target stockholders in 22% of transactions). 27% of purchase price adjustment claims were disputed, and 9% of claims originally brought as negative adjustments were converted to surpluses returned to target stockholders after discussions.
- *Earnouts*: Earnout milestones were achieved in 50% of all non–life sciences transactions. 10% of milestones that were initially claimed to be missed were disputed and resulted in negotiated payouts for target stockholders.

We reviewed all merger transactions between 2007 and 2013 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		2007	2008	2009	2010	2011	2012	2013
The number of deals we reviewed and the type of consideration paid in each	Sample Size	33	25	15	17	51	26	27
	Cash	48%	76%	60%	71%	73%	73%	59%
	Stock	0%	4%	0%	6%	4%	8%	8%
	Cash and Stock	52%	20%	40%	23%	23%	19%	33%

Deals with Earnout		2007	2008	2009	2010	2011	2012	2013
Deals that provided contingent consideration based upon post-closing performance of the target (other than balance sheet adjustments)	With Earnout	39%	12%	27%	29%	29%	31%	33%
	Without Earnout	61%	88%	73%	71%	71%	69%	67%

Deals with Indemnification		2007	2008	2009	2010	2011	2012	2013
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%	96%	100%	100%	98%	100%	100%
	By Buyer[1]	48%	48%	36%	17%	43%	62%	44%

Survival of Representations and Warranties		2007	2008	2009	2010	2011	2012	2013
Length of time that representations and warranties survived the closing for indemnification purposes[2]	Shortest	6 Months[3]	12 Months	6 Months	9 Months	12 Months[4]	10 Months	12 Months
	Longest	36 Months	24 Months	18 Months	21 Months	24 Months	24 Months	30 Months
	Most Frequent	12 and 18 Months (tie)	12 Months	18 Months	18 Months	18 Months	18 Months	18 Months

Caps on Indemnification Obligations		2007	2008	2009	2010	2011	2012	2013
Upper limits on indemnification obligations where representations and warranties survived the closing for indemnification purposes	With Cap	97%	95%	100%	100%	100%	100%	100%
	Limited to Escrow	78%	81%	71%	71%	77%	81%	88%
	Limited to Purchase Price	9%	14%	0%	6%	2%	0%	0%
	Exceptions to Limits[5]	97%	62%	71%	94%	96%	96%	100%
	Without Cap	3%	5%	0%	0%	0%	0%	0%

[1] The buyer provided indemnification in 53% of the 2007 transactions, 50% of the 2008 transactions, 40% of the 2009 transactions, 80% of the 2010 transactions, 29% of the 2011 transactions, 57% of the 2012 transactions, and 55% of the 2013 transactions where buyer stock was used as consideration. In 56% of the 2007 transactions, 25% of the 2008 transactions, 40% of the 2009 transactions, 33% of the 2010 transactions, 23% of the 2011 transactions, 25% of the 2012 transactions, and 50% of the 2013 transactions where the buyer provided indemnification, buyer stock was used as consideration.

[2] Measured for representations and warranties generally; specified representations and warranties may survive longer.

[3] In two cases representations and warranties did not survive, but in one such case there was indemnity for specified litigation, tax matters and appraisal claims.

[4] In one case representations and warranties did not survive.

[5] 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.

Escrows		2007	2008	2009	2010	2011	2012	2013
Deals having escrows securing indemnification obligations of the target's shareholders	With Escrow	94%	96%	93%	100%	94%	100%	93%[6]
	% of Deal Value							
	Lowest	3%	3%	10%	2%	5%	5%	5%
	Highest	43%	15%	15%	25%	31%	16%	20%
	Most Frequent	10%	10%	10%	10%	10%	10%	10%
	Length of Time							
	Shortest	6 Months	12 Months	12 Months	9 Months	12 Months	10 Months	12 Months
	Longest	60 Months	36 Months	18 Months	36 Months	36 Months	48 Months	30 Months
	Most Frequent	12 and 18 Months (tie)	12 Months	12 and 18 Months (tie)	18 Months	18 Months	12 Months	18 Months
	Exclusive Remedy	73%	83%	46%	53%	78%	73%	60%
	Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy[7]	100%	85%	83%	80%	97%	100%	100%
Baskets for Indemnification		**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Deals with indemnification where a specified "first dollar" amount did not count towards indemnification, expressed either as a "deductible" (where such amount can never be recovered) or as a "threshold" (where such dollar amount cannot be recovered below the threshold but once the threshold is met all such amounts may be recovered)	Deductible[8]	48%	43%[9]	43%	56%	38%	27%	50%
	Threshold[8]	39%	48%[9]	57%	44%	60%	65%	42%
MAE Closing Condition		**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Deals where the buyer or the target had as a condition to its obligation to close the absence of a "material adverse effect" with respect to the other party or its business, either in condition explicitly or through representation brought down to closing	Condition in Favor of Buyer	97%	88%	100%	100%	98%	95%	100%
	Condition in Favor of Target[10]	44%	21%	20%	19%	15%	9%	17%
Exceptions to MAE		**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Deals where the definition of "material adverse effect" for the target contained specified exceptions	With Exception[11]	91%	92%	93%	94%	94%[12]	84%[13]	96%[14]

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

[7] 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.

[8] A "hybrid" approach with both a deductible and a threshold was used in another 13% of these transactions in 2007, 4% of these transactions in 2008, 2% of these transactions in 2011, 8% of these transactions in 2012, and 8% of these transactions in 2013.

[9] Another 4% of these transactions had no deductible or threshold.

[10] In 86% of these transactions in 2007, 60% of these transactions in 2008, 100% of these transactions in 2009, 67% of these transactions in 2010, 86% of these transactions in 2011, 100% of these transactions in 2012, and 100% of these transactions in 2013, buyer stock was used as consideration.

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

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

[13] 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.

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

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