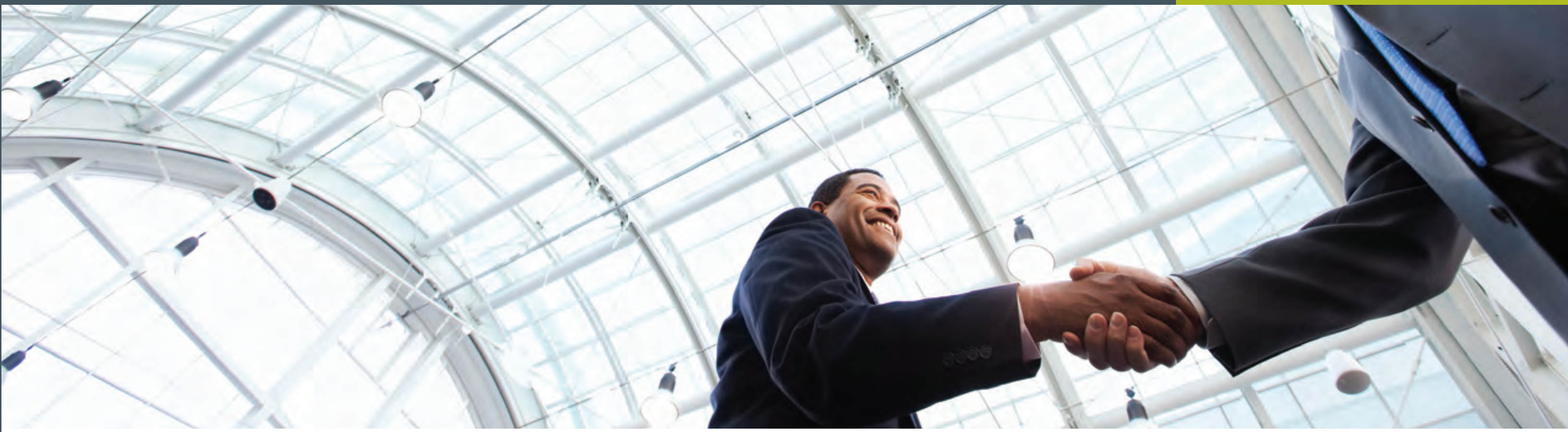
2016 M&A Report

CORPORATE



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REVIEW

Fueled by favorable macroeconomic conditions, high levels of cash among strategic acquirers and low interest rates, the M&A market produced record or near-record results across most geographies and sectors in 2015. Entering 2016, however, the M&A market faces several headwinds that may blunt advances in deal flow and valuations in the coming year.

The number of reported M&A transactions and deal value worldwide hit record levels in 2015. Global M&A deal volume increased 4%, from 31,963 deals in 2014 to 33,365 in 2015—eclipsing the 32,856 deals at the peak of the market in 2005. On the heels of a very strong M&A market in 2014, global M&A deal value surged by another 29%, from $3.01 trillion in 2014 to $3.89 trillion in 2015—more than double the average of $1.93 trillion for the three-year period that preceded 2014.

The number of worldwide billion-dollar transactions increased 10%, from 489 in 2014 to 536 in 2015. Aggregate global billion-dollar deal value grew 45%, from $2.02 trillion to $2.94 trillion.

Geographic Results

Total deal value increased across all geographic regions in 2015, with Asia-Pacific the only region seeing a decline in the number of M&A transactions:

- *United States*: Deal volume in the US increased 7%, from 11,692 transactions in 2014 to 12,465 in 2015. US deal value jumped 36%, from $1.70 trillion to $3.32 trillion, resulting in a 28% increase in average deal size from $145.5 million to $186.0 million—the highest total deal value and average deal size in the United States since at least 2000. The number of billion-dollar transactions involving US companies increased slightly, from 278 to 281, while the total value of these transactions grew 50%, from $1.30 trillion to $1.95 trillion.

- *Europe*: Deal flow in Europe improved in 2015 for the second consecutive year. The number of transactions increased 8%, from 13,155 in 2014 to 14,180 in 2015, surpassing the 13,704 in 2007—the European market's high point since at least 2000. Total deal value increased 29%, from $1.16 trillion to $1.50 trillion, resulting in a 20% increase in average deal size from $88.4 million to $105.9 million—just shy of the $107.5 million average deal size in 2007. The number of billion-dollar transactions involving European companies declined 4%, from 191 in 2014 to 184 in 2015—both years well below the 210 in 2006 and 263 in 2007. The total value of billion-dollar transactions, however, grew 44%, from $818.8 billion to $1.18 trillion, passing the $1.08 trillion figure for 2007.

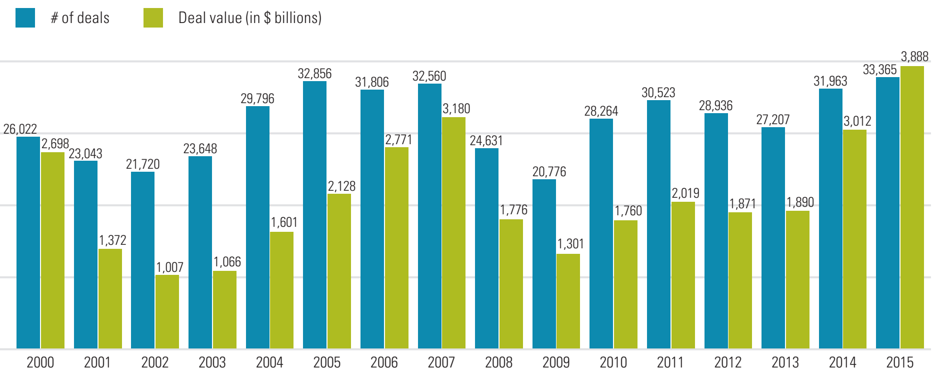
- *Asia-Pacific*: The Asia-Pacific region saw deal volume inch down by less than 1%, from 9,276 transactions in 2014 to 9,217 in 2015. Total deal value in the region, however, jumped 39%, from $704.6 billion to $980.4 billion, resulting in a 40% increase in average deal size from $76.0 million to $106.4 million—the highest total deal value and average deal size in the region since at least 2000. Billion-dollar transactions involving Asia-Pacific companies increased 73%, from 110 to 190, while their total value grew 75%, from $342.8 billion to $601.3 billion.

Sector Results

M&A deal flow increased across principal industry sectors in 2015. Trends in deal value were more varied, with annual tallies soaring in the financial services sector but sharply contracting in the telecommunications sector.

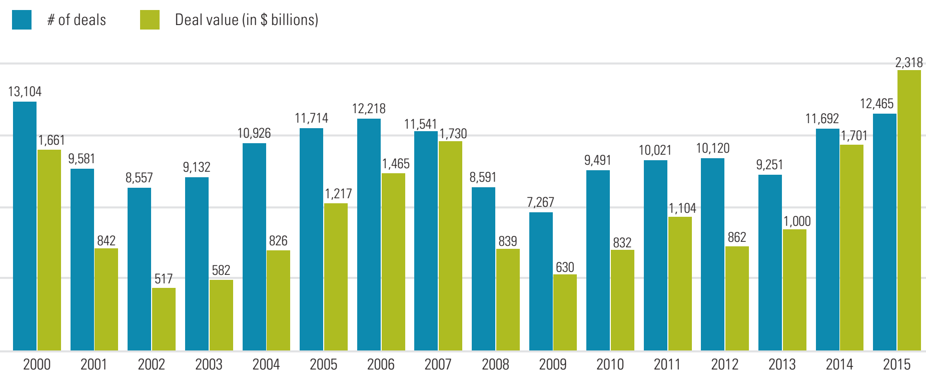
- *Technology*: Global transaction volume in the technology sector increased 9%, from 4,763 deals in 2014 to 5,197 deals in 2015. Global deal value increased 20%, from $234.2 billion to $280.9 billion, passing the $271.0 billion in 2000 as the high point in the sector since that year and resulting in a 10% increase in average deal size, from $49.2 million to $54.0 million. US technology deal volume increased 11%, from 2,424 to 2,684. US technology total deal value declined 7%, from $179.3 billion to $166.8 billion, resulting in a

Global M&A Activity – 2000 to 2015



Source: FactSet Mergers

US M&A Activity – 2000 to 2015

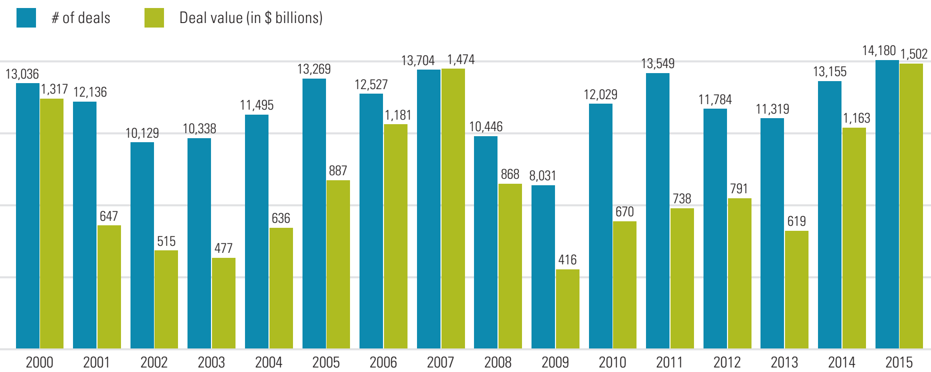


Source: FactSet Mergers

16% decline in average deal size from $74.0 million to $62.1 million—still the third-highest figure since 2000.

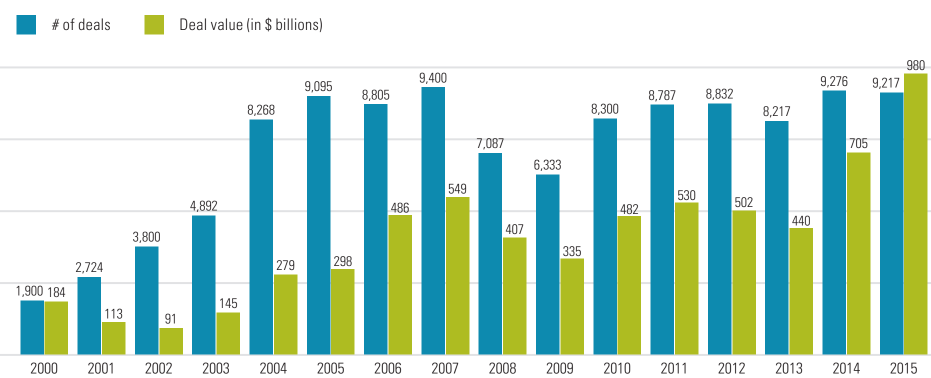
- *Life Sciences*: Global transaction volume in the life sciences sector dipped slightly, from 1,328 deals in 2014 to 1,324 deals in 2015, while global deal value increased 29%, from $385.2 billion to $498.7 billion. As a result, average deal size increased 30%, from $290.1 million to $376.6 million. In the United States, deal volume increased from 582 to 584, while total deal value increased 25%, from $313.7 billion to $393.1 billion. Average deal size increased from $539.1 million to $673.1 million.
- *Financial Services*: Global M&A activity in the financial services sector increased 7%, from 1,416 deals in 2014 to 1,517 deals in 2015. Despite this increase, the 2015 tally fell well short of the average of 1,726 deals that prevailed over the four-year period from 2004 to 2007. Global deal value more than doubled, from $125.2 billion to $255.5 billion, resulting in a 90% increase in average deal size from $88.4 million to $168.4 million. In the United States, financial services sector deal volume increased 6%, from 490 to 520, while total deal value more than tripled, from $46.1 billion to $152.9 billion. Average deal size increased from $94.1 million to $294.0 million—the highest average deal size in the sector since at least 2000.
- *Telecommunications*: Global transaction volume in the telecommunications sector inched up, from 809 deals in 2014 to 830 deals in 2015. Global telecommunications deal value declined 46%, from $241.4 billion to $129.4 billion, resulting in a 48% decline in the average deal size, from $298.3 million to $156.0 million. US telecommunications deal volume increased 8%, from 257 to 278, while total deal value declined 64%, from $102.1 billion to $36.4 billion. The average deal size in 2015, at $131.0 million, was less than one-third of the $397.1 million in 2014.
- *VC-Backed Companies*: The number of reported acquisitions of VC-backed companies declined 7%, from 562 in 2014 to 522 in 2015, while total proceeds fell by one-third, decreasing from $87.4 billion to $58.3 billion. Once all 2015 acquisitions are accounted for, 2015 deal activity should be in line with 2014, although the shortfall in proceeds is likely to remain due to a decline in the number of acquisitions with purchase prices of at least $500 million.

European M&A Activity – 2000 to 2015



Source: FactSet Mergers

Asia-Pacific M&A Activity – 2000 to 2015



Source: FactSet Mergers

OUTLOOK

Heading into 2016, macroeconomic concerns have created some uncertainty and begun to depress deal flow and valuations, suggesting that the M&A market is likely to step back from the record levels of 2015. Important factors that will affect M&A activity in the coming year include the following:

- *Macroeconomic Conditions*: While the US economy has continued to improve in a number of key metrics, global economic growth remains anemic at best, and slowing growth in China—until now a stalwart of economic growth—is having a ripple effect on many countries. Moreover, after seven years with interest rates at historic lows, the Federal Reserve raised its benchmark interest rate in late 2015, raising the specter of further hikes in 2016.
- *Private Equity Impact*: 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, private equity firms continue to have ample "dry powder" to deploy. Although competition for attractive deals is likely to continue in 2016, price inflation should abate.
- *Venture Capital Pipeline*: The venture capital pipeline is brimming with attractive acquisition targets, and many venture-backed companies and their investors prefer the relative ease and certainty of being acquired to the lengthier and more uncertain IPO process. In the coming year, activity in this sector will depend in part on the extent of the correction in private company valuations, a process which appears to be underway. ■

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"?

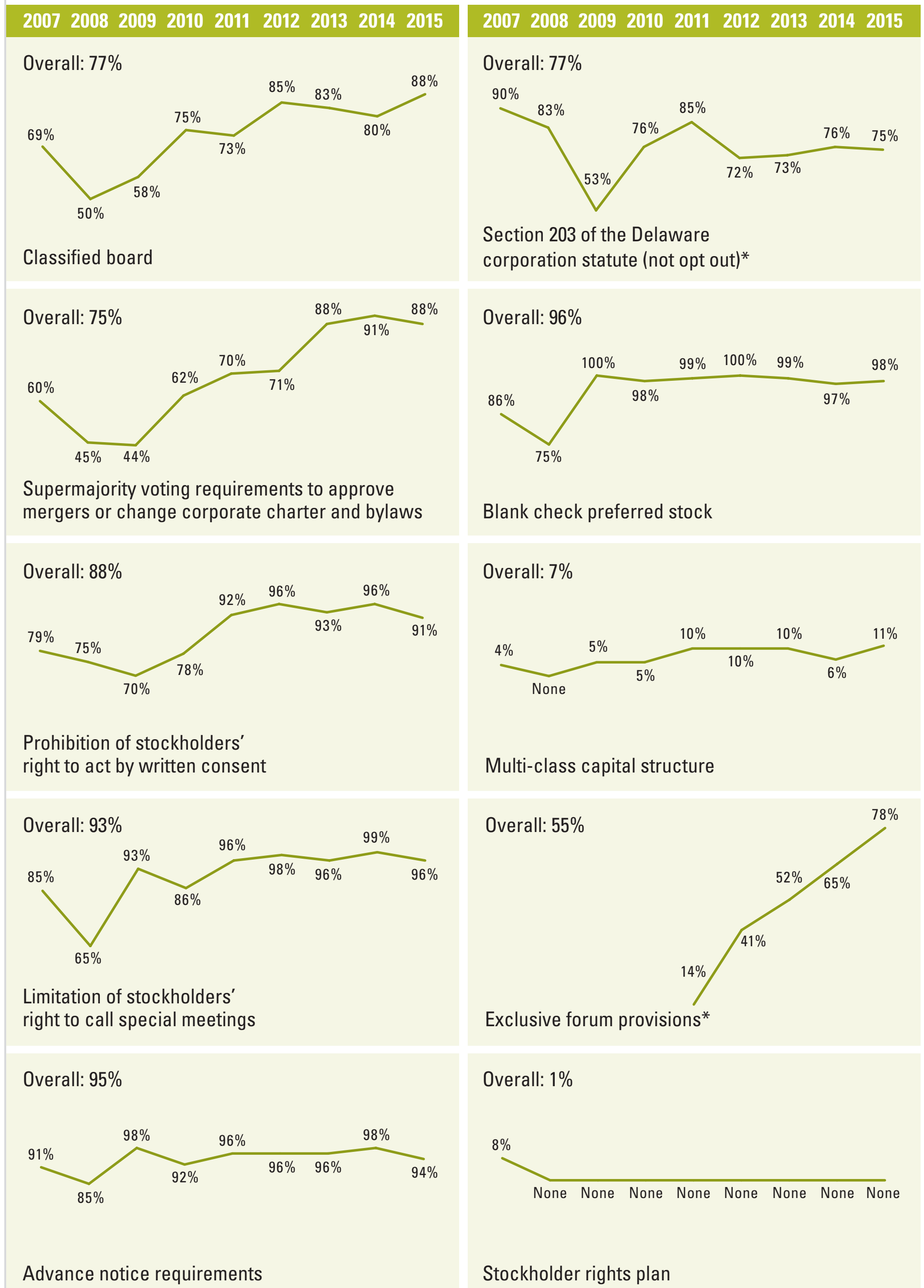
Advocates for supermajority vote requirements claim that these provisions help preserve and maximize the value of the company for all stockholders by ensuring that important corporate actions are taken only when it is the clear will of the stockholders. Opponents, however, believe that majority-vote 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 2015 (2011–2015 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	77%	10%	43%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	75%	21% to 42%, dependng on type of action	18% to 57%, dependng on type of action
Prohibition of stockholders' right to act by written consent	88%	71%	72%
Limitation of stockholders' right to call special meetings	93%	39%	51%
Advance notice requirements	95%	95%	91%
Section 203 of the Delaware corporation statute (not opt out)*	77%	96%	89%
Blank check preferred stock	96%	96%	95%
Multi-class capital structure	7%	9%	11%
Exclusive forum provisions*	55%	30%	33%
Stockholder rights plan	1%	4%	7%

**Delaware corporations only*
Source: IPO company data is based on WilmerHale analysis of SEC filings from 2007 to 2015 (2011–2015 only for exclusive forum provisions) for US issuers. Established public company data is from SharkRepellent.net at year-end 2015.

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 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 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%	88%	78%	49%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	75%	84%	78%	51%
Prohibition of stockholders' right to act by written consent	88%	94%	90%	70%
Limitation of stockholders' right to call special meetings	93%	96%	97%	81%
Advance notice requirements	95%	98%	97%	85%
Section 203 of the Delaware corporation statute (not opt out)*	77%	97%	39%	73%
Blank check preferred stock	96%	97%	99%	89%
Multi-class capital structure	7%	6%	6%	12%
Exclusive forum provisions*	55%	51%	66%	50%
Stockholder rights plan	1%	2%	0.5%	1%

**Delaware corporations only*
Source: WilmerHale analysis of SEC filings from 2007 to 2015 (2011–2015 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. 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 2010 decision by the Delaware Court of Chancery (and now expressly authorized by the Delaware corporation statute), 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 state-law stockholder claims may be brought against the company and its directors. 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. ■

Much has been written about the increased prevalence of appraisal claims in public company mergers, but the risk of appraisal claims in mergers involving private companies should not be ignored.

Subject to various exceptions and conditions, Section 262 of the Delaware General Corporation Law gives a stockholder of a constituent corporation in a merger the right to seek appraisal of the fair value of the stockholder's shares if the stockholder does not vote in favor of, or consent in writing to, the merger. For mergers that are approved by written consent of stockholders (as is often the case for privately held corporations), the surviving corporation is obligated to give notice of the merger and the availability of appraisal rights to stockholders before or within ten days after the effective date of the merger, and stockholders who have not consented to the merger are entitled to exercise appraisal rights within 20 days after the date of the notice.

Buyers should assess at the outset of a transaction whether circumstances exist that might suggest a heightened risk of appraisal claims, such as a conflicted board; a defective sale process; allocation of little or no merger proceeds to common stockholders; allocation to management (as part of a management incentive or similar plan) of merger proceeds that otherwise would be allocated to common stockholders; or a dissatisfied stockholder base, including founders who are no longer employees and who might have an economic or emotional incentive to disrupt a sale process.

In addition, buyers should be mindful of several Delaware cases suggesting reluctance to uphold a waiver of appraisal rights after the effectiveness of a merger where the stockholder is not offered consideration incremental to the merger consideration to which the stockholder is entitled by virtue of the merger:

- In *Roam-Tel Partners v. AT&T Mobility Wireless Operations Holdings, Inc.*, a stockholder who received no consideration for a waiver of appraisal rights was permitted to revoke the stockholder's waiver within the 20-day statutory exercise period where the stockholder did not actually accept the merger consideration. The court distinguished the facts in an earlier case, *Shell Petroleum, Inc. v. Smith*, in which the stockholder was offered $2.00 per share for an appraisal rights waiver in addition to the merger consideration and noted that, in such a case, an enforceable contract does arise because the waiver is supported by consideration.
- In *Halpin v. Riverstone National, Inc.*, in response to the majority stockholder's argument that a drag-along provision obligated minority stockholders to consent to a merger after its effectiveness and that such consent would constitute a waiver of the minority stockholders' appraisal rights, the court held that the minority stockholders were not obligated to consent to the merger after the fact because the majority stockholder failed to provide prior notice of the merger, as required by the express terms of the drag-along provision, thereby resulting in an ineffective exercise of the majority stockholder's drag-along rights.
- Finally, in another case, the court held that the obligation to deliver a release as part of a letter of transmittal was unenforceable against a stockholder because the stockholder was not provided any consideration beyond the merger consideration to which it had already become entitled when the merger was consummated.

In assessing and attempting to mitigate the risk of appraisal claims in sales of privately held Delaware corporations, buyers should be mindful of five key lessons from these cases:

- While holders of preferred stock can waive statutory appraisal rights in advance under Delaware law, it remains unclear whether common stockholders can do the same. Accordingly, buyers should not assume that a purported waiver of appraisal rights by a common stockholder in a stockholders' agreement is enforceable under Delaware law. In the face of this uncertainty, drag-along provisions should include proxies and powers of attorney allowing the company to vote on behalf of the stockholder parties, which should preclude preferred stockholders and, at least in theory, common stockholders from pursuing appraisal claims.
- Buyers should consider any procedural requirements carefully when drafting drag-along provisions because compliance may prove impracticable within the often-accelerated time frame of a transaction. When exercising drag-along rights in the context of a transaction, failure to comply strictly with any procedural requirements included in the drag-along provisions may result in an invalid exercise of the drag-along rights.
- If a drag-along provision requires that the transaction terms applicable to dragging stockholders be the same as the terms applicable to dragged stockholders—which is a common feature of drag-along provisions—buyers should consider whether any value or benefit (including, for example, having board designees released from claims) not shared by all stockholders could be the basis for a claim that stockholders are being treated disparately and that therefore the exercise of the drag-along provision is invalid.
- Buyers should not assume that a stockholder's execution of a written consent to a merger following the effectiveness of the merger constitutes a vote in favor of the merger sufficient to preclude an appraisal claim. As noted in *Halpin*, it is unclear under Delaware law whether shares that are converted at the effective time of the merger into the right to receive merger consideration or seek appraisal are capable of being voted after the merger.
- If mitigation of appraisal claims is critical to a buyer in a particular deal, the buyer might consider (1) requiring a dissenting share closing condition, in which it is not required to close until holders of a specified percentage (such as 95%) of the outstanding common stock have executed written consents to the merger or until the statutory period for exercising appraisal rights has passed, (2) allocating a specified percentage of the overall merger proceeds as consideration for appraisal rights waivers for common stockholders, and/or (3) requesting a special indemnity from the target's stockholders for post-closing appraisal claims. ■

BACKGROUND

It used to be that boards of public companies being acquired would routinely face one or (likely) more lawsuits alleging the directors breached their fiduciary duties because they had agreed to sell too cheaply or engaged in a flawed sales process. These lawsuits were often resolved through relatively straightforward settlements, in which the company agreed to make supplemental disclosures in exchange for dismissal of the lawsuit, a release of all potential claims, and payment of a fee to plaintiffs' counsel. At the same time, companies funneled deal litigation into the Delaware Court of Chancery through forum selection by-laws requiring intra-corporate litigation be brought in the company's state of incorporation (typically Delaware) or headquarters in an effort to reduce the costs of multi-forum deal litigation.

The Chancery Court routinely approved such settlements. But the times, they are a-changin.'

Recently the Chancery Court has scrutinized proposed settlements and rejected those where it concluded the claims lacked merit or the releases were too generous. As a result, deal litigation has fallen. According to a *Wall Street Journal* review of filings, just 34% of sales of Delaware companies for more than $100 million from October through December of 2015 faced lawsuits—down from 78% for the first nine months of 2015, and 95% for 2014.

This is great news for Delaware public companies, which have long complained that such suits are essentially a deal tax. Although it may be premature to declare complete victory, these recent trends suggest the number of suits should continue to fall. But suits outside Delaware and more meritorious suits in Delaware—for example, those alleging undisclosed banker conflicts—will remain. Below, we summarize some important recent decisions by the Chancery Court and discuss potential strategies for opposing merger-related lawsuits.

RECENT DECISIONS

In July 2015, Vice Chancellor Laster signaled this new era of increased scrutiny by refusing to approve a settlement in *Acevedo v. Aeroflex Holding Corp.* In his ruling, he noted that the Chancery Court had routinely approved these settlements out of sympathy for defendants, who absent settlement would likely face costly litigation even in non-meritorious cases. But "with easy money to be had, M&A litigation proliferated" and plaintiffs' attorneys' fees climbed. He concluded that shareholders were not receiving any quantifiable benefit and were releasing claims that shareholders' attorneys could never (because of the limited discovery performed and vast breadth of so-called "intergalactic" releases) have investigated closely. In the final analysis, he measured the give (i.e., disclosures and other relief) against the get (i.e., a broad class-wide release), found they did not square, and rejected the settlement. In the following months, several other members of the Chancery Court expressed similar reservations about these settlements.

In January 2016, Chancellor Bouchard rejected a proposed settlement in *In re Trulia, Inc.*, warning that disclosure-only settlements will be met with "disfavor" absent a "plainly material" supplemental disclosure and a narrowly tailored release. His lengthy opinion echoed the same concerns voiced by the other members of the Chancery Court and may foreshadow the end to what some snidely referred to as "deal insurance" settlements.

POTENTIAL APPROACHES TO DEAL LITIGATION

With disclosure-only settlements facing a hostile reception in Delaware, plaintiffs may pursue deal litigation in other states. Below are some approaches to defending these suits.

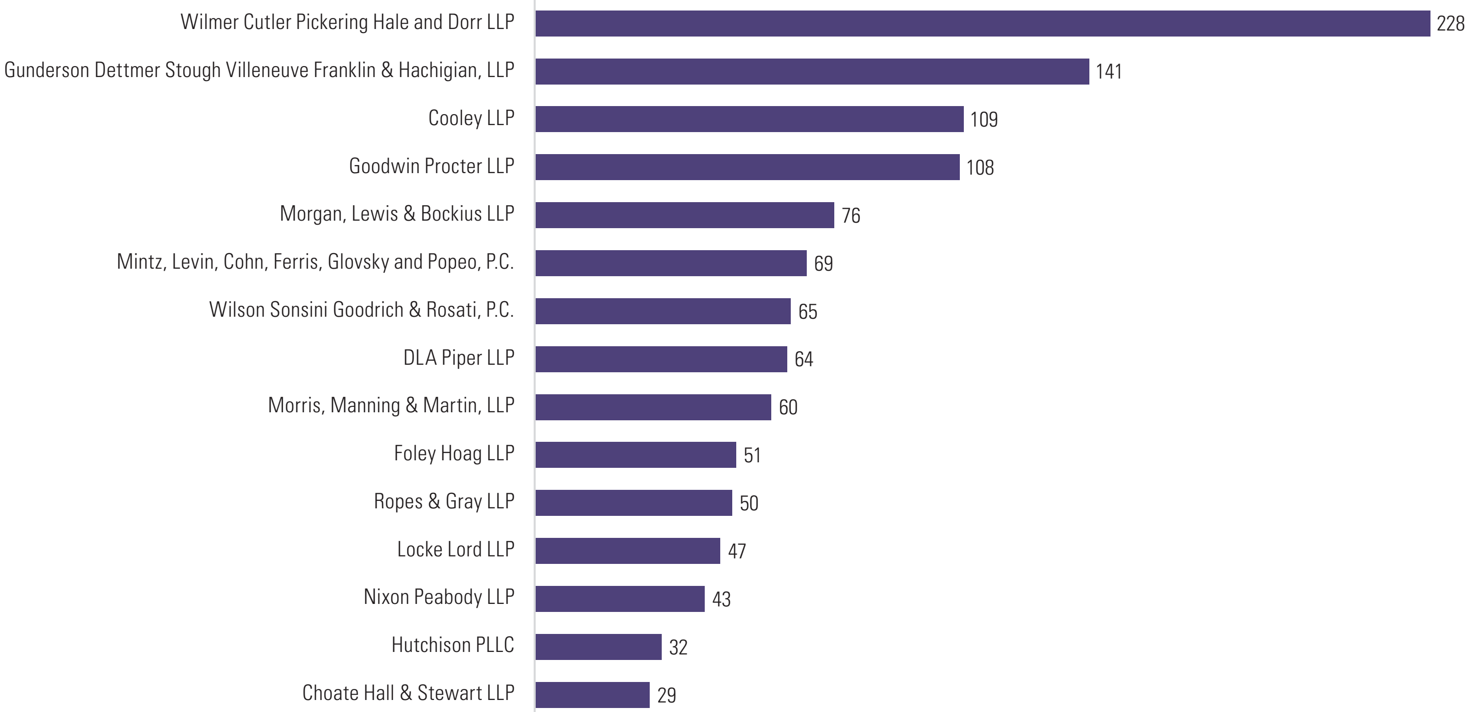
- *Adopt exclusive forum bylaws*: Exclusive forum bylaw provisions (which generally can be adopted without shareholder approval) can funnel deal litigation to Delaware, where the Chancery Court will likely examine it more closely, and move to dismiss cases filed elsewhere.
- *Oppose expedited discovery/treatment*: The Chancery Court frequently refuses expedited treatment when a deal is well-disclosed and follows a good process. Companies can pursue that approach outside Delaware. Without expedited treatment or after a well-grounded motion to dismiss, plaintiffs may fold their cards and voluntarily dismiss.
- *Stay Delaware litigation in favor of another state*: Alternatively, companies could take their chances outside Delaware, where courts may more willingly approve disclosure-only settlements. However, without the benefit of the Chancery Court's expertise, another court may be more likely to allow a case to proceed to expedited discovery, may struggle with a preliminary injunction motion, and may be less likely to dismiss even a non-meritorious case.

If the parties choose to settle in Delaware, the options may now be more limited:

- *Negotiate more narrowly tailored releases*: Instead of agreeing to "intergalactic" releases, plaintiffs may now release only disclosure or fiduciary duty claims concerning the sales process. The Chancery Court has said it would approve such settlements because they would not foreclose other future, meritorious claims.
- *Settle only after more extensive discovery and potentially a preliminary injunction hearing*: Plaintiffs may seek more extensive discovery, instead of the typical expedited discovery that the Chancery Court has criticized, or may push forward and seek a preliminary injunction. Such efforts may give the Chancery Court comfort that plaintiffs' counsel has investigated and the parties have vigorously explored the existence of potentially meritorious claims before settling.
- *Voluntarily dismiss and pay mootness fee*: Another alternative endorsed by the Chancery Court is for plaintiffs to dismiss the case voluntarily after defendants make agreed-upon disclosures. Plaintiffs' counsel will seek a so-called mootness fee, and the Chancery Court will likely require some form of notice informing shareholders of the dismissal before considering the fee. This approach, however, does not include a release of claims.

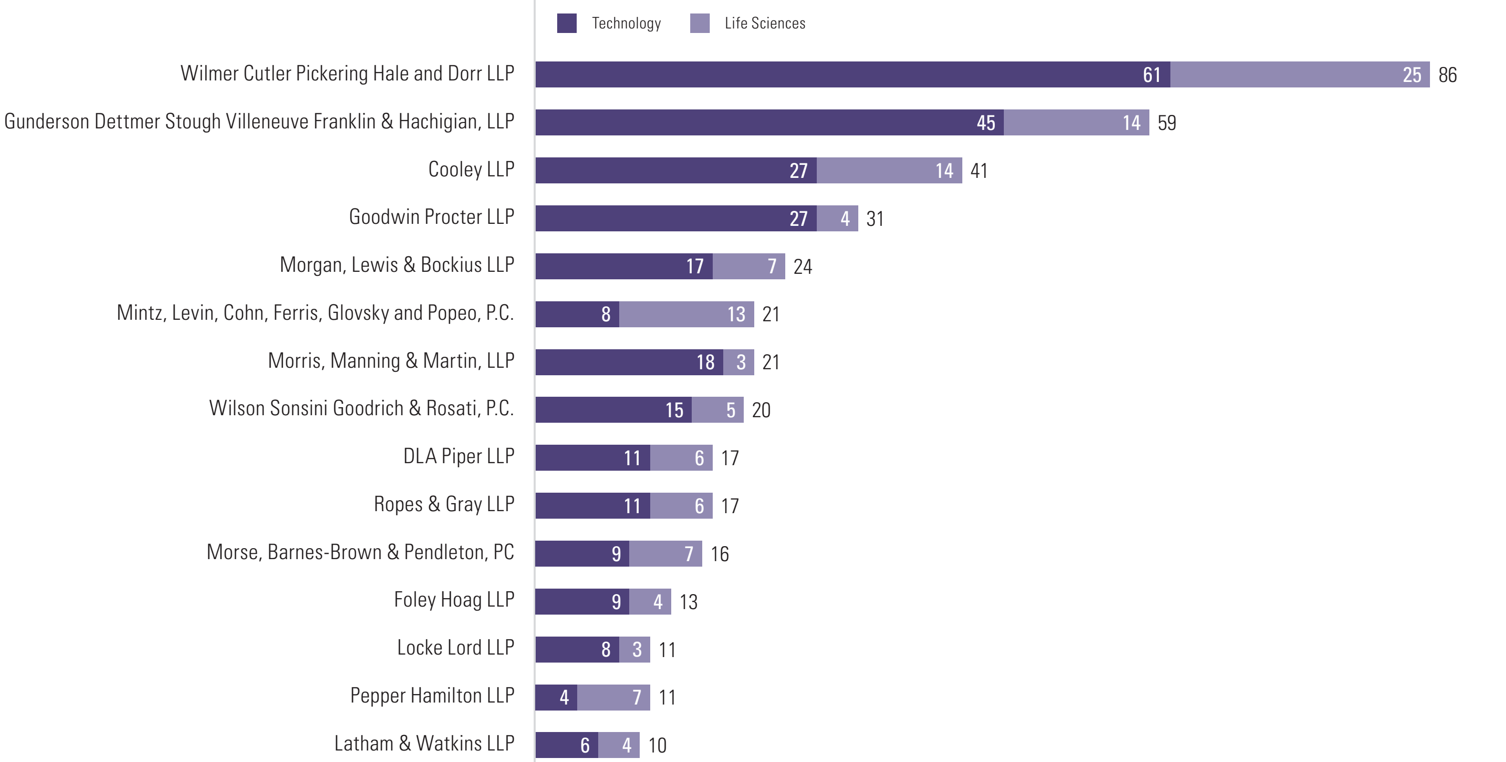
It is not entirely clear how the Chancery Court will apply the new "plainly material" disclosure standard or whether disclosure-only settlements remain viable. It is clear, however, that although far fewer merger suits will be filed, those filed will be subject to more rigorous litigation and may proceed post-closing. Early on in the deal process, companies should seek advice on how best to reduce deal litigation if it arises. ■

Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2015



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 2015



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, ENERGY AND CLEANTECH, FINANCIAL SERVICES, DEFENSE, COMMUNICATIONS AND BEYOND

STAPLES
Acquisition of
Office Depot
$6,300,000,000
Pending
(as of March 15, 2016)

asics
Acquisition of
FitnessKeepers
Undisclosed
March 2016

Akamai
Acquisition of
Codemate
$107,500,000
April 2015

redhat
Acquisition of
Ansible
$125,500,000
October 2015

Cumberland Farms
Sale of Gulf Oil business to
ArcLight Capital Partners
Undisclosed
December 2015

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

SANBOLIC
Acquisition by
Citrix Systems
$89,600,000
January 2015

BARCLAYS
Sale of US wealth and investment management business to
Stifel
Undisclosed
December 2015

DANAHER
Acquisition of
Laetus
Undisclosed
December 2015

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

TEMENOS
Acquisition of
Akcelerant Software
$50,000,000
February 2015

Booz | Allen | Hamilton
Acquisition of the software services business of
SPARC
Undisclosed
October 2015

demandware
Acquisition of
Tomax
$75,000,000
(including contingent payments)
January 2015

ANALOG DEVICES
Acquisition of
Hittite Microwave
$2,500,000,000
July 2014

PROGRESS
Acquisition of
Telerik
$262,500,000
December 2014

Sonus
Acquisition of
Performance Technologies
$50,000,000
February 2014

wex
Acquisition of
Electronic Funds Source
$1,485,000,000
Pending
(as of March 15, 2016)

LoopPay
Acquisition by
Samsung
Undisclosed
February 2015

TiVo
Acquisition of
Cubiware
$48,000,000
(including contingent payments)
May 2015

NEXAGE
Acquisition by
Millennial Media
$107,500,000
December 2014

smarterer
Acquisition by
Pluralsight
$75,000,000
November 2014

NaturalMotion
Acquisition by
Zynga
$527,000,000
February 2014

KRONOS
Acquisition of
Empower Software
Undisclosed
January 2016

ENDURANCE
Acquisition of
Ace Data Centers
$73,300,000
September 2015

DURATA THERAPEUTICS
Acquisition by
Actavis
$760,000,000
November 2014

OXITEC
Acquisition by
Intrexon
$160,000,000
September 2015

PAREXEL
Acquisition of
Health Advances
Undisclosed
February 2016

Bottomline Technologies
Acquisition of
Intellinx
$66,700,000
January 2015

BACARDI
Acquisition of
Angel's Share Brands
Undisclosed
March 2015

cCAM Biotherapeutics
Acquisition by
Merck
$510,000,000
(including contingent payments)
July 2015

TEI BIOSCIENCES
Acquisition by
Integra LifeSciences
$312,000,000
July 2015

ThermoFisher SCIENTIFIC
Acquisition of Alfa Aesar research chemicals business of
Johnson Matthey
£256,000,000
September 2015

WILMERHALE®

The Hart-Scott-Rodino Act (HSR Act) requires parties to a merger or acquisition meeting certain size thresholds—generally, at least $78.2 million (as of February 25, 2016)—to report their transaction to the Federal Trade Commission (FTC) and the Department of Justice (DOJ) and to observe the prescribed waiting period. Observance of the HSR waiting period is a significant enforcement issue at both the FTC and the DOJ.

ANTITRUST WAITING PERIOD

Most parties understand that they are prohibited from actually closing the transaction until the HSR waiting period expires or is terminated. Under the antitrust laws, however, the parties must continue to act as independent entities until the closing. In their haste to prepare themselves for life post-closing, parties can cross the line between permissible integration planning and impermissible transfer of control. Parties that breach the waiting period—through conduct known as "gun jumping"—can be charged with violations of the antitrust laws and find their transaction bogged down in a collateral investigation.

The HSR Act imposes a 30-day moratorium on closing every reportable transaction, while the reviewing agency conducts what is typically only a brief review of the HSR filing. If the transaction appears to raise antitrust concerns, however, the initial review may involve analyzing market share data, contacting customers, examining the business plans of the parties, and interviewing key personnel from the parties. If the agency believes that the transaction will not "substantially lessen competition," it can either terminate the waiting period before the expiration of the 30 days or allow the waiting period to expire on the 30th day.

If—after the initial review—the reviewing agency believes the transaction raises competitive concerns, or if more time is needed to investigate properly, the reviewing agency can extend the waiting period by issuing a "Second Request," which typically involves the production of a substantial amount of additional documents, information and economic analyses. A Second Request can extend the waiting period for large transactions raising significant competitive issues by several months or more.

Integration DO's and DON'Ts

Below are general guidelines to avoid alleged gun-jumping offenses:

- **DO** share only information that is necessary for normal due diligence purposes and assessment of future integration. If pricing or other highly sensitive information must be shared, its dissemination should be limited to employees of the other party who need to know and who are not involved in setting prices for that party.
- **DO** be alert to actions of the acquiror that could be construed as exercising control over the business decisions of the target company. The acquiror should not go beyond what is necessary to monitor compliance with provisions in the merger agreement requiring the target company to conduct its business in the ordinary course. Restrictions imposed on the target company to protect the investment of the acquiror—relating to significant asset sales, incurrence of significant debt and similar matters—are considered legitimate.
- **DO** maintain separate identities. Neither party should change its name to that of the other party or to the contemplated post-closing name of the combined company.
- **DO** be cautious about involving the employees of one party in the decision-making processes of the other party. There can be significant antitrust implications when one party is permitted to review and approve actions to be taken by the other party.
- **DON'T** agree on the prices or other terms on which products or services are to be sold.
- **DON'T** allocate customers or markets between the parties. For example, parties that compete for business through bids should continue to bid for customers according to their pre-existing plans. One party should not withdraw from a bid opportunity simply because its acquisition partner is a competing bidder.
- **DON'T** swap employees or assign employees from one party to the other.
- **DON'T** assign responsibility for the target company's business to the acquiror's employees.

The length of the HSR review process often creates a tension between the need to observe the HSR requirements and the need to prepare for integration of two independent companies. Furthermore, in many transactions, particularly those involving public companies requiring shareholder approval to complete the deal, closing may not take place until months after HSR approval is received.

INTEGRATION PLANNING NEEDS

In the period between signing an acquisition agreement and closing the transaction, the parties have a legitimate need to prepare to integrate their operations:

- The parties want to hit the ground running when the transaction closes. The ability of the combined company to compete on Day One may depend on the seamless transition of control from the target company to the acquiror, without disruption to either party's businesses.
- The target company may be concerned that its key employees will abandon the company while the transaction is pending, thereby potentially reducing the value of the target company to the acquiror and impairing the target company's operations whether or not the acquisition is completed. The acquiror has an equally compelling interest in preventing the devaluation of the business it is about to acquire.
- The anticipated benefits from the transaction may diminish if the parties are required to wait a long period until closing before they can prepare to integrate operations.

Restrictions on pre-closing activities can be frustrating to parties facing an extended HSR review or post-HSR period before closing. With proper guidance, however, parties should be able to achieve most of their pre-closing goals without undue risk of gun-jumping violations. ■

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 tightly drafted, and give the acquirer little room to refuse to complete the transaction if all required regulatory and stockholder approvals are obtained.
- *Post-Closing Obligations*: Post-closing escrow or indemnification arrangements are very 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 2015. The ABA private target study covers acquisitions that were completed in 2014, and the ABA public target study covers acquisitions that were announced in 2014 (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 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-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, 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.

"10b-5" Representation	
PUBLIC (ABA)	5%
PRIVATE (ABA)	25%
PRIVATE (SRS|ACQUIOM)	45%

Standard for Accuracy of Target Reps at Closing	
PUBLIC (ABA)	
"MAC/MAE"	92%
"In all material respects"	2%
Other standard	6%
PRIVATE (ABA)	
"MAC/MAE"	24%
"In all material respects"	19%
"In all respects"	5%
Combination	52%
PRIVATE (SRS|ACQUIOM)	
"MAC/MAE"	31%
"In all material respects"	64%
"In all respects"	5%

Inclusion of "Prospects" in MAC/MAE Definition	
PUBLIC (ABA)	2%
PRIVATE (ABA)	12%
PRIVATE (SRS|ACQUIOM)	17%

Fiduciary Exception to "No-Talk" Covenant	
PUBLIC (ABA)	100%
PRIVATE (ABA)	10%
PRIVATE (SRS|ACQUIOM)	4%

Opinion of Target's Counsel as Closing Condition	
PUBLIC (ABA)	–
PRIVATE (ABA)	11%
PRIVATE (SRS|ACQUIOM)	16%

Appraisal Rights Closing Condition	
PUBLIC (ABA)	
All cash deals	None
Part cash/part stock deals	13%
PRIVATE (ABA)	
All deals	49%
PRIVATE (SRS|ACQUIOM)	
All deals	61%

Acquirer MAC/MAE Closing Condition	
PUBLIC (ABA)	100%
PRIVATE (ABA)	91%
PRIVATE (SRS|ACQUIOM)	97%

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 (not all metrics discussed below were reported for all periods). 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 fallen sharply from 19% of acquisitions announced in 2004 to just 5% of acquisitions announced in 2014 (but up from 2% in 2013).
- *Accuracy of Target Reps at Closing*: The MAC/MAE standard for accuracy of the target's representations at closing remains predominant, present in 92% of acquisitions announced in 2014 compared to 89% of acquisitions announced in 2004 (and having peaked at 100% in 2010). 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 included in the MAC/MAE definition in only 2% of acquisitions announced in 2014, representing a sharp decline in frequency from 10% of acquisitions announced in 2004.
- *Fiduciary Exception to "No-Talk" Covenant*: The fiduciary exception in 90% of acquisitions announced in 2014 was based on the concept of "an acquisition proposal expected to result in a superior offer," up from 79% in 2004 but down from 98% in 2012, while the standard based on the mere existence of any "acquisition proposal," which had disappeared entirely from acquisitions announced in 2011–2012, was present in 7% of acquisitions announced in 2014 (down from 9% in 2013). The standard based on an actual "superior offer" declined from 11% in 2004 to 3% in 2014. 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 3% of acquisitions announced in 2007. The incidence of these provisions grew to 11% in 2013, before decreasing to 2% in 2014.
- *Appraisal Rights Closing Condition*: No cash acquisitions announced in 2014 had an appraisal rights closing condition, completing the decline from 13% of cash acquisitions announced in 2005–2006. An appraisal rights closing condition appeared in 13% of cash/stock acquisitions announced in 2014, down sharply from 26% in 2013 and 28% in 2005–2006 but well above the low point of 4% in 2011.

In transactions involving *private* company targets:

- *"10b-5" Representations*: The prevalence of these representations has declined from 59% of acquisitions completed in 2004 to 25% of acquisitions completed in 2014.
- *Accuracy of Target Reps at Closing*: The MAC/MAE standard for accuracy of the target's representations at closing has gained wider acceptance, appearing in some form in 43% of acquisitions completed in 2014 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 12% of acquisitions completed in 2014, down from 36% of acquisitions completed in 2006.
- *Fiduciary Exception to "No-Talk" Covenant*: Fiduciary exceptions were present in 10% of acquisitions completed in 2014, compared to 25% of acquisitions completed in 2008.
- *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 11% of acquisitions completed in 2014.
- *Appraisal Rights Closing Condition*: An appraisal rights closing condition was included in 49% of acquisitions completed in 2014, up from 43% of acquisitions completed in 2008. ■

Post-Closing Claims

SRS|Acquiom has released a study analyzing post-closing escrow claim activity in 720 private target acquisitions in which it served as shareholder representative from 2010 through 2014. This study provides a glimpse into the hidden world of post-closing escrow claims in private acquisitions:

- *Expense Fund*: Median size of $200,000 (0.25% of transaction value). 75% of deals used less than 10% of expense fund.
- *Frequency of Claims*: 60% of all transactions had at least one post-closing indemnification claim (including purchase price adjustments) against the escrow. 25% had more than one claim.
- *Size of Claims*: On average, claims represented 24% of the escrow. 6% of all deals had claims match or exceed the escrow, and 9% of all deals had claims for half or more of the escrow. Largest claims were for fraud and breach of fiduciary duty.
- *Bases for Claims*: Most frequently claimed misrepresentations involved tax (18% of transactions), intellectual property (11% of transactions), undisclosed liabilities (8% of transactions) and employee-related (8% of transactions).
- *Resolution of Claims*: 9% of all transactions with claims had claims litigated or arbitrated. On average, contested claims were resolved in seven months.
- *Purchase Price Adjustments*: 77% of all transactions had mechanisms for purchase price adjustments. Of these, 65% had a post-closing adjustment (favorable to the acquirer in 48% of transactions and favorable to target stockholders in 17% of transactions).
- *Earnouts*: In non–life sciences transactions, 56% of milestones that came due were paid to some degree and 15% of milestones that were initially claimed to be missed were disputed and resulted in negotiated payouts for target stockholders.

Special Considerations in Sales of Venture-Backed Companies

Sales of venture-backed companies raise a number of unique issues. Some arise from the complex capital structures of most venture-backed companies, including the presence of multiple classes of preferred stock and the relatively greater prevalence of optionholders and warrantholders among the holders of equity. Other issues, such as the means by which acquirors seek to secure indemnification obligations and concerns about liquidity of the acquiror's stock issued in payment of the purchase price, are primarily related to deal size and the nature of the parties involved. And looming over the resolution of all these issues are the fiduciary duties of the target's directors, even when the company is private.

EFFECT OF PREFERRED STOCK RIGHTS ON DEAL STRUCTURE

Addressing the rights of multiple classes of equity stakeholders in the sale of a venture-backed company requires a close reading of the target's charter documents and can be challenging. Some points to consider include:

- The liquidation preference that each class of preferred stock is entitled to receive will be an important factor in determining how a transaction should be structured.
- In many cases, the purchase price may be insufficient to trigger conversion of all preferred stock or to satisfy the liquidation preference of each class of preferred stock.
- Where separate class votes are required to approve the sale of the target, there is sometimes a "re-trading" of the purchase price among the various classes of preferred stock in order to obtain a favorable vote from each class. This is often accomplished through a charter amendment, but must be structured carefully to comply with the target board's fiduciary duties (particularly if the board includes directors who are nominees of or affiliated with preferred stockholders).

Another complicating factor is the identity of the parties required to participate in the post-closing indemnification obligations. While it may initially seem fair for each equity participant to share proportionately in the indemnification obligations, the company's charter may provide otherwise. A resolution will often require significant changes to a deal's liability structure; at the very least, the solution probably will make the escrow arrangements more complex.

A related issue arises if the target's charter contains a "no impairment" clause, which generally prevents the company from taking any action that would have the effect of impairing the preferred shareholders' rights. To avoid running afoul of this kind of charter provision, the acquiror may need to structure the deal so that no one class is singled out for less favorable treatment than other classes (except to the extent provided in the charter), even where the holders of that particular class are not otherwise an important part of the transaction.

Consequently, a solid understanding of the target's preferred stock rights—and the fiduciary duties of the target's directors—is critical to an acquiror's ability to structure a transaction that will secure board and shareholder approval and proceed smoothly toward completion.

TREATMENT OF STOCK OPTIONS, RESTRICTED STOCK AND WARRANTS

Most venture-backed companies grant stock options and restricted stock to employees as an incentive to retain them, often at lower levels of cash compensation than are otherwise available in the marketplace. Similarly, warrants are frequently issued to lenders, landlords and vendors in an attempt to stretch early-stage cash. An acquiror must be fully conversant with the target's stock plans and documents since they will determine whether the treatment of those instruments will be simple and straightforward (as in situations where options and warrants can be bought out with a cash payment) or more complicated (as in cases where the desired treatment of options, restricted stock and warrants is not contemplated by, or is in contravention of, their terms).

In circumstances where outstanding options and warrants cannot be cashed out, and particularly where they form a disproportionately large segment of the target's equity, the acquiror faces a dilemma with respect to the deal's indemnification and escrow arrangements:

- On one hand, it is usually better (from the acquiror's perspective) to have as many of the selling equityholders obligated to stand behind the representations, warranties and covenants as possible, so excepting a large group of optionholders and warrantholders from this liability is not ideal.
- On the other hand, trying to include optionholders and warrantholders in the indemnification arrangements tends to complicate the escrow mechanisms—sometimes enormously so.

To compound the dilemma, excluding target employees who hold options from the indemnification and escrow arrangements while including target employees who hold restricted stock results in disparate treatment of employees based simply on the form of equity they hold. Furthermore, acquirors are usually reluctant to make indemnification claims against the target's key employees—who often hold the bulk of the target's options—when they join the acquiror following deal completion. As a result, acquirors often seek to place the entire escrow burden on the non-employee shareholders. Trying to strike the proper balance among these considerations is frequently difficult and sometimes contentious.

INDEMNIFICATION AND ESCROW TERMS

Target shareholders are typically expected to indemnify acquirors for breaches of representations, warranties and covenants, and these indemnities are usually secured with escrows. The details of these arrangements, however, often require extensive negotiations, as the outcome can fundamentally affect deal economics for sellers. Customary parameters include:

- a cap on indemnification liability, almost always set below the purchase price and, with respect to claims for breaches of representations and warranties (but not other claims), typically limited to the escrow, with exceptions that include fraud and willful misrepresentations as well as capitalization, authority, validity and other fundamental matters;

- an escrow, typically equal to 10% to 15% of the purchase price and lasting 12–18 months; and
- agreement that the escrow is the acquiror's exclusive remedy under the indemnity, subject to negotiated exceptions.

Please see pages 18–19 of this report for a more detailed analysis of trends in indemnification, escrow and other terms in sales of venture-backed companies.

DEAL PROTECTION

Acquirors of private companies want to fully lock up a deal as early in the sale process as possible in order to reduce the risk of a superior offer upsetting the deal. In contrast, it has long been viewed as both legally mandated and customary for public company transactions to contain some exclusivity exceptions, thereby allowing the target's board of directors to discharge its fiduciary duty to obtain the best value for shareholders (although this general consensus has not prevented the actual parameters of these exceptions from continuing to be heavily negotiated in each public company transaction).

In spite of the desire of acquirors for deal certainty, the boards of venture-backed target companies must be cognizant of their fiduciary duty to maximize shareholder value, just like their public company counterparts. Venture-backed company boards often try to discharge this duty by seeking either:

- to contact other potential acquirors in order to perform a "market check" on the deal's terms prior to signing a definitive agreement or agreeing to exclusivity; or
- the right to accept an unsolicited superior bid and terminate the original purchase agreement prior to closing, or at least a right to change the board's recommendation to shareholders.

Without fiduciary duty exceptions to the exclusivity provisions, a target board could be forced to choose among:

- breaching its fiduciary duties by locking up a deal prematurely;
- breaching the acquisition agreement's exclusivity provisions if a better offer surfaces; or
- avoiding a breach of fiduciary duty claim by waiting until the "drop dead" date in the acquisition agreement to explore alternative transactions, but thus risking the loss of both the original and the alternative offer due to lapse of time (and possibly violating a covenant in the acquisition agreement to use best efforts to close the original deal).

The above provisions are usually the subject of fierce debate, both on a conceptual level and within the confines of each particular transaction. These issues are also present when a letter of intent containing exclusivity restrictions is signed for a prospective transaction.

Acquirors have attempted to strike a balance between the need of target boards to perform at least some baseline market check and the desire of acquirors to lock up deals as quickly possible by drawing on precedents from public company acquisitions, such as:

- limiting the number of shares bound by voting agreements to less than a majority; or
- coupling the target board's termination rights with breakup fees that would have to be considered as part of the board's evaluation of alternative offers.

One approach to lock up the acquisition of a venture-backed target (and that typically is unavailable for a public company target) is to require shareholder approval of the transaction (often by written consent) promptly after the agreement has been signed. This mechanism is sometimes coupled with the acquiror's right to terminate the agreement if the target shareholders fail to approve the transaction within a short period of time after its execution, thus minimizing the length of time during which the deal's closing is uncertain. The risk of not obtaining shareholder approval can be further reduced as the result of a 2014 amendment to the Delaware stockholder consent statute, which now permits prospective execution of shareholder consents that can become effective upon the occurrence of a subsequent event (such as the approval and execution of the definitive merger agreement).

LIQUIDITY OF DEAL CONSIDERATION

The issuance of the acquiror's securities as deal consideration can raise challenging securities law issues. To have meaningful liquidity, the shares must be registered, either upon issuance or following the closing. If the shares cannot be issued pursuant to registration or a valid exemption from registration, the acquisition cannot be closed with stock consideration.

Pre-closing registration on Form S-4 will delay the closing. Post-closing registration on Form S-3 is more common because it permits a quicker closing, but poses several risks to the target's shareholders:

- The shares received cannot be resold until the registration statement becomes effective, although this delay may be brief and should not be a concern at all if the acquiror qualifies as a "well-known seasoned issuer" under SEC rules.
- If the acquiror has the right to delay or terminate the registration (for example, because of unannounced material developments within the acquiror), the target shareholders may be left with illiquid shares for some period of time.
- Selling shareholders under the Form S-3 are potentially liable for misstatements or omissions, although they may have recourse against the acquiror under indemnity provisions in the acquisition agreement.

Post-closing registration is only possible if the acquiror can issue its securities at closing pursuant to an exemption from registration. If the target has too many equityholders for a valid exemption, the issuance usually must be made pursuant to a pre-closing Form S-4 registration statement. Alternatively, the acquiror might be able to cash out options and/or certain classes of stock to reduce the number of target shareholders and qualify for an exemption from registration, but this would further complicate the allocation of the purchase price, and may present fiduciary duty issues for the target's board.

The preferred approach in any given transaction will depend heavily on the factual circumstances of the transaction and the long-term plans of the target's shareholders. ■

We reviewed all merger transactions between 2008 and 2015 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		2008	2009	2010	2011	2012	2013	2014	2015
The number of deals we reviewed and the type of consideration paid in each	Sample Size	25	15	17	51	26	27	37	27
	Cash	76%	60%	71%	73%	73%	59%	59%	67%
	Stock	4%	0%	6%	4%	8%	8%	3%	4%
	Cash and Stock	20%	40%	23%	23%	19%	33%	38%	29%

Deals with Earnout		2008	2009	2010	2011	2012	2013	2014	2015
Deals that provided contingent consideration based upon post-closing performance of the target (other than balance sheet adjustments)	With Earnout	12%	27%	29%	29%	31%	33%	30%	26%
	Without Earnout	88%	73%	71%	71%	69%	67%	70%	74%

Deals with Indemnification		2008	2009	2010	2011	2012	2013	2014	2015
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	96%	100%	100%	98%	100%	100%	97%	100%
	By Buyer	48%	36%	17%	43%	62%	44%	49%	69%

Survival of Representations and Warranties		2008	2009	2010	2011	2012	2013	2014	2015
Length of time that representations and warranties survived the closing for indemnification purposes[1]	Shortest	12 Mos.	6 Mos.	9 Mos.	12 Mos.	10 Mos.	12 Mos.	12 Mos.	12 Mos.
	Longest	24 Mos.	18 Mos.	21 Mos.	24 Mos.	24 Mos.	30 Mos.	24 Mos.	24 Mos.
	Most Frequent	12 Mos.	18 Mos.	18 Mos.	18 Mos.	18 Mos.	18 Mos.	12 & 18 Mos. (tie)	18 Mos.

Caps on Indemnification Obligations		2008	2009	2010	2011	2012	2013	2014	2015
Upper limits on indemnification obligations where representations and warranties survived the closing for indemnification purposes	With Cap	95%	100%	100%	100%	100%	100%	100%	100%
	Limited to Escrow	81%	71%	71%	77%	81%	88%	89%	79%
	Limited to Purchase Price	14%	0%	6%	2%	0%	0%	0%	0%
	Exceptions to Limits[2]	62%	71%	94%	96%	96%	100%	100%	100%
	Without Cap	5%	0%	0%	0%	0%	0%	0%	0%

[1] 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.

[2] 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		2008	2009	2010	2011	2012	2013	2014	2015
Deals having escrows securing indemnification obligations of the target's shareholders	With Escrow	96%	93%	100%	94%	100%	93%[3]	97%	93%
	% of Deal Value								
	Lowest[4]	3%	10%	2%	5%	5%	5%	2%	4%
	Highest	15%	15%	25%	31%	16%	20%	16%	16%
	Most Frequent	10%	10%	10%	10%	10%	10%	10%	10%
	Length of Time								
	Shortest	12 Mos.	12 Mos.	9 Mos.	12 Mos.	10 Mos.	12 Mos.	12 Mos.	12 Mos.
	Longest	36 Mos.	18 Mos.	36 Mos.	36 Mos.	48 Mos.	30 Mos.	24 Mos.	36 Mos.
	Most Frequent	12 Mos.	12 & 18 Mos. (tie)	18 Mos.	18 Mos.	12 Mos.	18 Mos.	12 Mos.	12 & 18 Mos. (tie)
	Exclusive Remedy	83%	46%	53%	78%	73%	60%	86%	63%
	Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy[2]	85%	83%	80%	97%	100%	100%	100%	100%

Baskets for Indemnification		2008	2009	2010	2011	2012	2013	2014	2015
Deals with indemnification only for amounts above a specified "deductible" or only after a specified "threshold" amount is reached	Deductible[5]	43%[6]	43%	56%	38%	27%	50%	44%	31%
	Threshold[5]	48%[6]	57%	44%	60%	65%	42%	56%	61%

MAE Closing Condition		2008	2009	2010	2011	2012	2013	2014	2015
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	88%	100%	100%	98%	95%	100%	97%	100%
	Condition in Favor of Target	21%	20%	19%	15%	9%	17%	19%	12%

Exceptions to MAE		2008	2009	2010	2011	2012	2013	2014	2015
Deals where the definition of "material adverse effect" for the target contained specified exceptions	With Exception[7]	92%	93%	94%	94%[8]	84%[9]	96%[10]	100%	100%

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

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

[5] A "hybrid" approach with both a deductible and a threshold was used in another 4% of these transactions in 2008, 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.

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

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

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

[9] 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.

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

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Data Sources: M&A data is sourced from MergerStat. 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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