M&A Report

2019

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2019 M&A Report – What's Inside

REVIEW

With favorable macroeconomic conditions prevailing for much of 2018, high levels of cash among strategic acquirers and interest rates still at historically low levels (despite four interest rate hikes during the year), the number of reported M&A transactions and total deal value both increased worldwide.

The number of M&A transactions worldwide edged up less than 1%, from 53,064 deals in 2017 to 53,366 in 2018. Global M&A deal value increased 11%, from $3.21 trillion to $3.56 trillion.

The average deal size in 2018 was $66.7 million, up 10% from $60.5 million in 2017 and $60.4 million in 2016 but lower than the $70.1 million figure for 2015.

The number of worldwide billion-dollar transactions increased 12%, from 500 in 2017 to 559 in 2018. Aggregate global billion-dollar deal value increased 18%, from $1.91 trillion to $2.25 trillion.

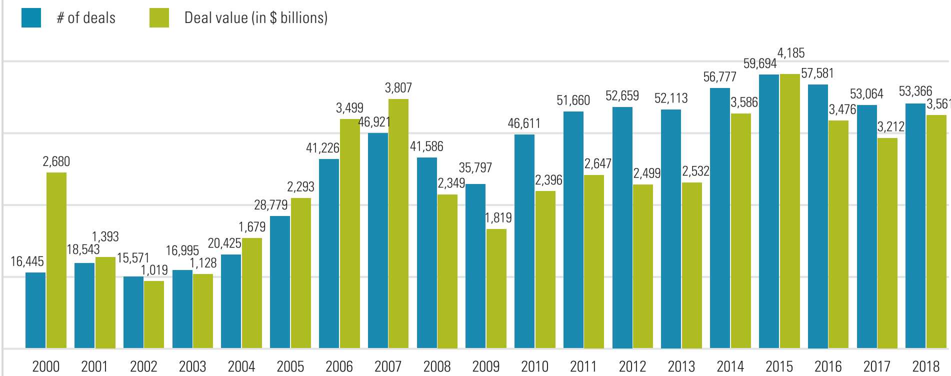
GEOGRAPHIC RESULTS

Deal volume and aggregate deal value increased across most geographic regions in 2018:

— *United States*: Deal volume increased 2%, from 19,296 transactions in 2017 to 19,757 in 2018. US deal value increased 12%, from $1.96 trillion to $2.20 trillion. Average deal size increased 10%, from $101.3 million in 2017 to $111.1 million in 2018—the highest average deal size in the United States since the $115.6 million figure for 2007. The number of billion-dollar transactions involving US companies increased 8%, from 318 in 2017 to 343 in 2018, while the total value of these transactions increased 17%, from $1.38 trillion to $1.62 trillion.

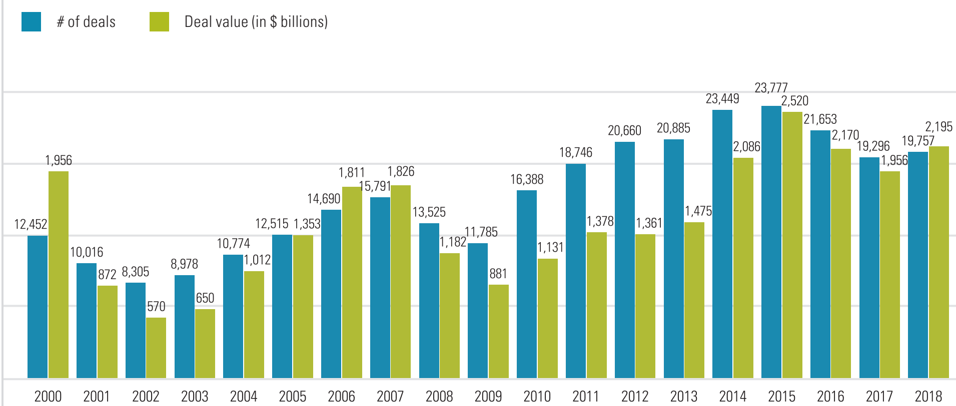
— *Europe*: The number of transactions in Europe decreased for the third consecutive year, declining by 5%, from 21,482 in 2017 to 20,460 in 2018. Total deal value, however, increased 21%, from $1.16 trillion to $1.40 trillion—the third-highest figure since 2007, behind only the totals of $1.56 billion in 2014 and $1.57 billion in 2015. Average deal size increased 27%, from $53.8 million in 2017 to $68.3 million in 2018. The number of billion-dollar transactions involving European companies increased by 4%, from 201 in 2017 to 209 in 2018. The total value of billion-dollar transactions increased by almost one-third, from $723.9 billion in 2017 to $960.7 billion in 2018.

Global M&A Activity – 2000 to 2018



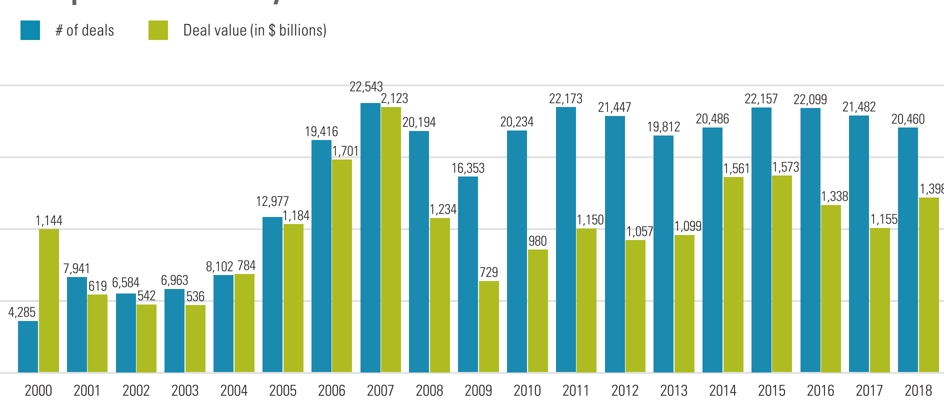
Source: S&P Global Market Intelligence

US M&A Activity – 2000 to 2018



Source: S&P Global Market Intelligence

European M&A Activity – 2000 to 2018



Source: S&P Global Market Intelligence

— *Asia-Pacific*: The Asia-Pacific region saw deal volume increase 3%, from 13,407 transactions in 2017 to 13,874 in 2018. Total deal value in the region increased 7%, from $969.4 billion in 2017 to $1.04 trillion in 2018, while average deal size increased by 3%, from $72.3 million to $74.8 million. The number of billion-dollar transactions involving Asia-Pacific companies increased 10%, from 145 in 2017 to 160 in 2018, while their total value increased by 17%, from $491.9 billion to $574.3 billion.

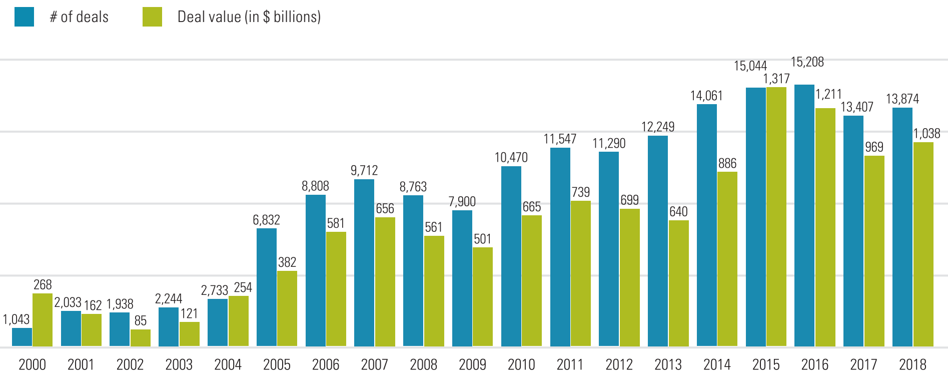
SECTOR RESULTS

The strength of the overall M&A market in 2018, in terms of both global deal value and average deal size, was generally reflected across industry sectors. Among technology and life sciences companies worldwide, transaction volume increased, and deal value and average deal size saw even larger gains. In the financial services and communications sectors, global deal volume decreased modestly but global deal value and average deal size both increased substantially. M&A trends across sectors in the United States were largely consistent with global results.

— *Technology*: Global transaction volume in the technology sector increased 8%, from 7,485 deals in 2017 to 8,058 deals in 2018. Global deal value grew 37%, from $300.4 billion to $411.6 billion. Average deal size increased 27%, from $40.1 million in 2017 to $51.1 million in 2018. US technology deal volume increased 7%, from 3,118 to 3,328 transactions. Total US technology deal value jumped 54%, from $202.6 billion to $311.4 billion, resulting in a 44% increase in average deal size, from $65.0 million to $93.6 million.

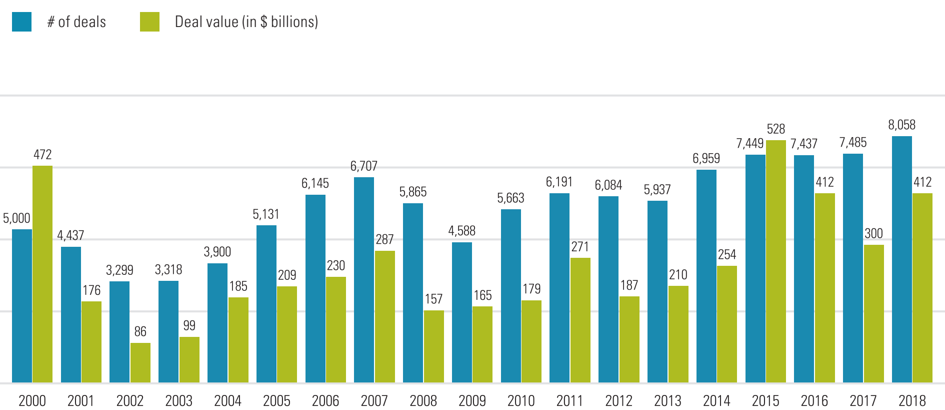
— *Life Sciences*: Global transaction volume in the life sciences sector increased 30%, from 1,314 deals in 2017 to 1,703 deals in 2018, while global deal value surged 77%, from $154.9 billion to $274.3 billion—the third-highest annual figure ever recorded, trailing only the figures of $276.5 billion in 2015 and $297.8 billion in 2014. Average deal size increased 37%, from $117.9 million to $161.0 million. In the United States, deal volume increased by 28%, from 539 to 689 transactions. Total deal value increased by nearly two-thirds, from $118.3 billion to $194.1 billion, resulting in an increase in average deal size of 28%, from $219.5 million to $281.8 million.

Asia-Pacific M&A Activity – 2000 to 2018



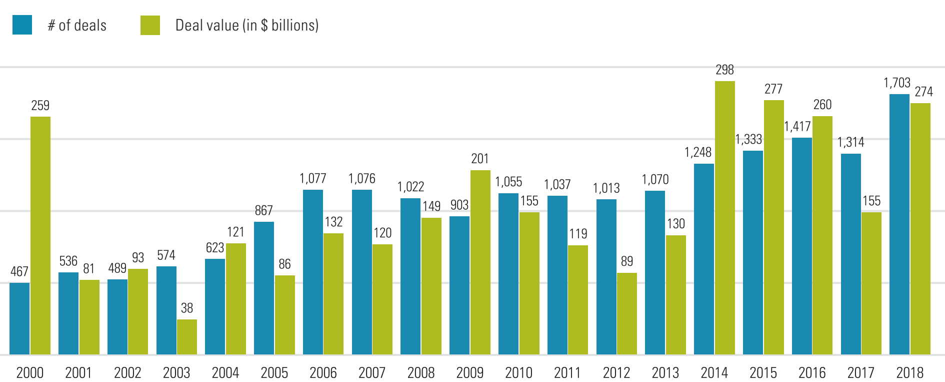
Source: S&P Global Market Intelligence

Technology M&A Activity – 2000 to 2018



Source: S&P Global Market Intelligence

Life Sciences M&A Activity – 2000 to 2018



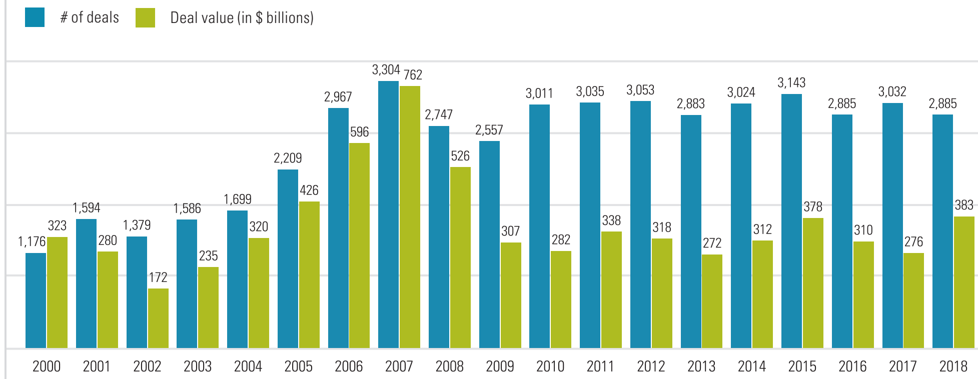
Source: S&P Global Market Intelligence

— *Financial Services*: Global M&A activity in the financial services sector dipped by 5%, from 3,032 deals in 2017 to 2,885 deals in 2018. However, global deal value increased by 39%, from $275.7 billion to $383.0 billion, resulting in a 46% increase in average deal size, from $90.9 million to $132.8 million. In the United States, financial services sector deal volume slipped 3%, from 1,305 to 1,270 transactions, while total deal value climbed 53%, from $160.5 billion to $245.7 billion. Average US deal size increased 57%, from $123.0 million to $193.5 million.

— *Telecommunications*: Global transaction volume in the telecommunications sector declined 5%, from 712 deals in 2017 to 679 deals in 2018. Global telecommunications deal value more than doubled, from $80.6 billion to $172.7 billion, resulting in a 125% increase in average deal size, from $113.2 million to $254.4 million. US telecommunications deal volume increased from 188 to 191 transactions, while total deal value increased 129%, from $43.4 billion to $99.2 billion. The average US telecommunications deal size more than doubled, from $230.7 million to $519.5 million.

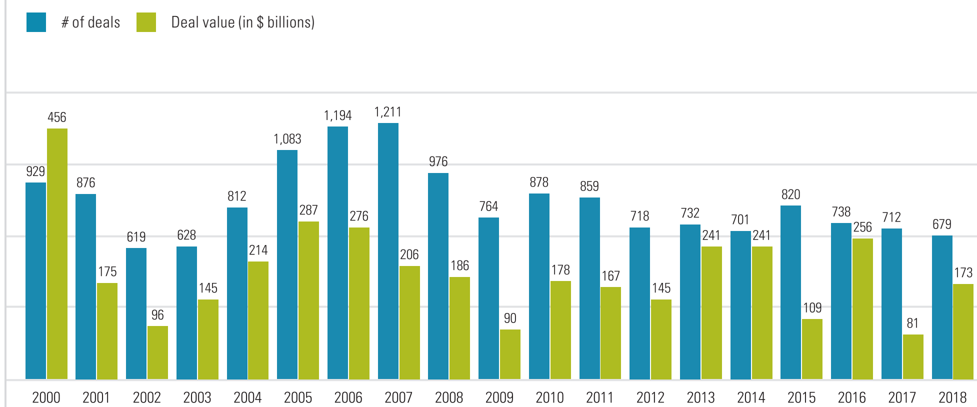
— *VC-Backed Companies*: The number of reported acquisitions of US VC-backed companies increased by 11%, from 707 in 2017 to 784 in 2018, while total proceeds soared from $89.4 billion to $146.2 billion—a record-high annual total, surpassing the $121.2 billion figure for 2014.

Financial Services M&A Activity – 2000 to 2018



Source: S&P Global Market Intelligence

Telecommunications M&A Activity – 2000 to 2018



Source: S&P Global Market Intelligence

OUTLOOK

The outlook for the M&A market over the coming year appears bright. Despite signs of weakening economic growth in some major economies, resilient equity markets combined with low interest rates are likely to continue to encourage companies to pursue acquisitions to supplement organic growth. Important factors that will affect M&A activity over the balance of 2019 include the following:

— *Macroeconomic Conditions*: The US economy remains strong, with growth exceeding expectations in the first quarter of 2019 and the lowest level of unemployment in decades. The prospect of stable interest rates for the balance of 2019—as indicated by the Federal Reserve in March—should also help buoy M&A activity. Headwinds remain, however, including weaker performance in some economies, notably Europe and Asia, and the escalation of trade tensions that risk destabilizing an already inconsistent global macroeconomic environment.

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

— *Private Equity Activity*: On the buy side, private equity firms continue to hold record levels of "dry powder" to deploy, although fundraising in 2018 declined by one-quarter from the record-setting level of 2017. On the sell side, PE firms are facing pressure to exit investments and return capital to investors, even if investor returns are dampened by increases in the level of equity invested in acquisitions.

— *VC-Backed Company Pipeline*: In the coming year, the volume of sales of VC-backed companies will depend in part on their valuations—which reached a record high in 2018—as well as the health of the IPO market. The attractive valuations and solid aftermarket performance of VC-backed IPOs in 2018—which increased in number by 52% from 2017—should prompt additional IPOs over the next year. ■

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

CLASSIFIED BOARDS

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

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

SUPERMAJORITY VOTING REQUIREMENTS

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

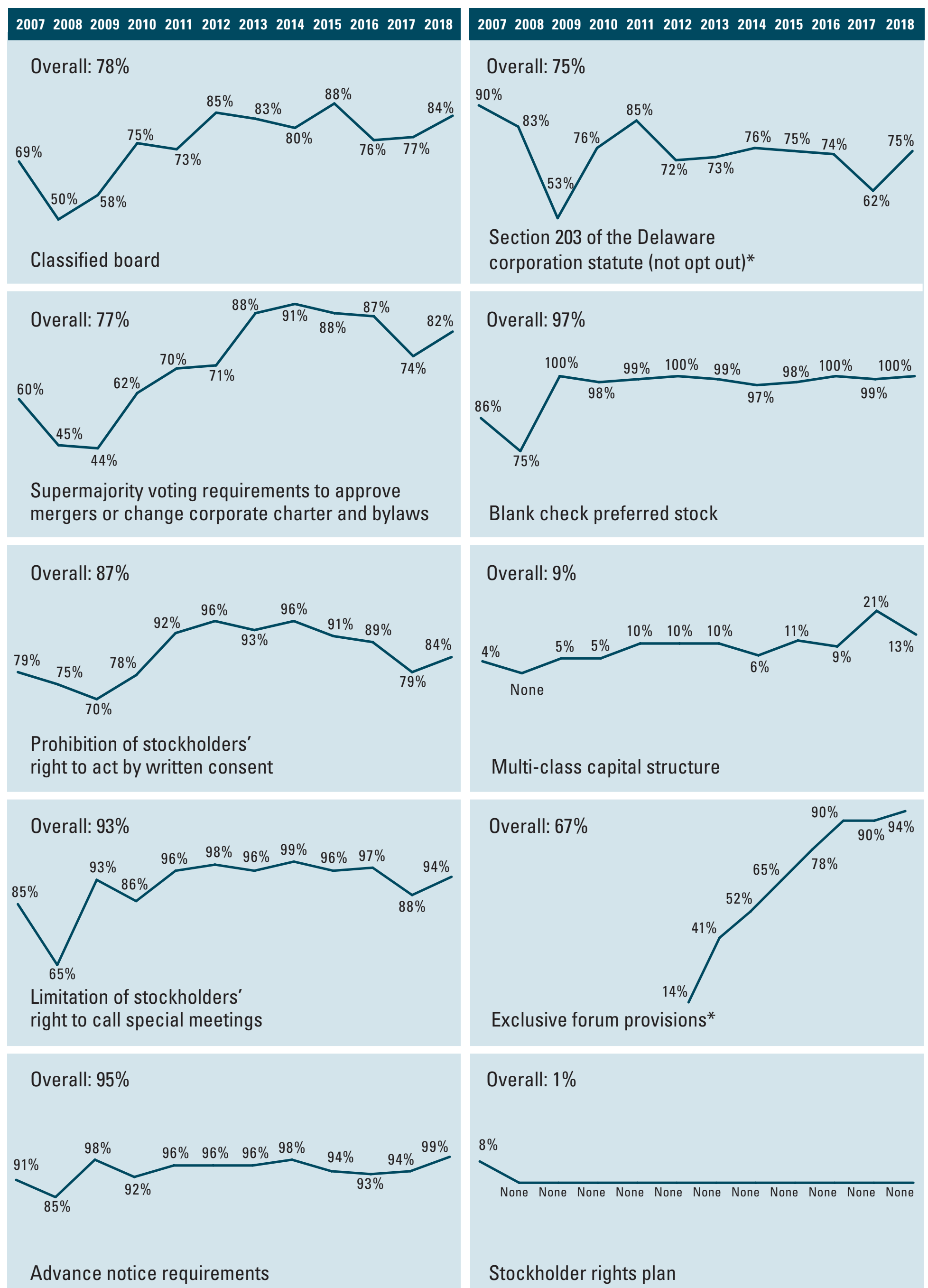
Advocates for supermajority vote requirements claim that these provisions help preserve and maximize the value of the company for all stockholders by ensuring that important corporate actions are taken only when it is the clear will of the stockholders. Opponents, however, believe that majority-vote requirements make the company more accountable to stockholders by making it easier for stockholders to change how the company is governed, and that improved accountability leads to better performance. Supermajority requirements are also viewed by their detractors as entrenchment devices 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 2018 (2011–2018 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.

STATE ANTI-TAKEOVER LAWS

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

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

BLANK CHECK PREFERRED STOCK

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

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

PREVALENCE OF TAKEOVER DEFENSES AMONG IPO COMPANIES AND ESTABLISHED PUBLIC COMPANIES

	IPO COMPANIES	ESTABLISHED PUBLIC COMPANIES	
		S&P 500	RUSSELL 3000
Classified board	78%	11%	43%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	77%	21% to 40%, depending on type of action	18% to 57%, depending on type of action
Prohibition of stockholders' right to act by written consent	87%	70%	74%
Limitation of stockholders' right to call special meetings	93%	35%	51%
Advance notice requirements	95%	96%	93%
Section 203 of the Delaware corporation statute (not opt out)*	75%	96%	82%
Blank check preferred stock	97%	95%	95%
Multi-class capital structure	9%	8%	10%
Exclusive forum provisions*	67%	41%	46%
Stockholder rights plan	1%	1%	3%

**Delaware corporations only*
Source: IPO company data is based on WilmerHale analysis of SEC filings from 2007 to 2018 (2011–2018 only for exclusive forum provisions) for US issuers. Established public company data is from SharkRepellent.net at year-end 2018.

DIFFERENCES IN ANTI-TAKEOVER PRACTICES AMONG TYPES OF IPO COMPANIES

	ALL IPO COMPANIES	VC-BACKED COMPANIES	PE-BACKED COMPANIES	OTHER IPO COMPANIES
Classified board	78%	89%	80%	51%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	77%	86%	79%	51%
Prohibition of stockholders' right to act by written consent	87%	94%	90%	67%
Limitation of stockholders' right to call special meetings	93%	97%	96%	81%
Advance notice requirements	95%	98%	98%	86%
Section 203 of the Delaware corporation statute (not opt out)*	75%	96%	37%	68%
Blank check preferred stock	97%	98%	99%	92%
Multi-class capital structure	9%	9%	7%	13%
Exclusive forum provisions*	67%	65%	74%	60%
Stockholder rights plan	1%	1%	<0.5%	1%

*Delaware corporations only
Source: WilmerHale analysis of SEC filings from 2007 to 2018 (2011–2018 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 some or all pre-IPO stockholders hold shares of common stock that are entitled to multiple votes per share, while the public is issued a separate class of common stock that is entitled to only one vote per share, or no voting rights at all. Use of a multi-class capital structure facilitates the ability of the holders of the high-vote stock to retain voting control over the company and to pursue strategies to maximize long-term stockholder value. Critics believe that a multi-class capital structure entrenches the holders of the high-vote stock, insulating them from takeover attempts and the will of public stockholders, and that the mismatch between voting power and economic interest may increase the possibility that the holders of the high-vote stock will pursue a riskier business strategy.

EXCLUSIVE FORUM PROVISIONS

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

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

STOCKHOLDER RIGHTS PLANS

Should the company establish a poison pill?

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

Fighting the Rising Tide of Federal Disclosure Suits

In recent years, there has been a dramatic rise in the number of M&A disclosure lawsuits filed in federal court. Courts have begun to fight back against this nuisance litigation, using different approaches.

For many years, "disclosure-only" settlements have been a staple of the plaintiffs' bar in M&A transactions. Such settlements arise from lawsuits—usually filed within days of a merger announcement—that allege defendants failed to disclose material information related to the deal. Typically, plaintiffs file these suits as class actions after a deal is announced but before it closes, and often seek a preliminary injunction to delay the shareholder vote on the deal until the company makes further disclosures. Wanting to avoid jeopardizing the deal or delaying the vote, companies will often agree to disclose additional information regardless of whether the claims are meritorious, and plaintiffs will usually agree to drop the preliminary injunction and dismiss the individual plaintiffs' claims with prejudice, and then seek attorneys' fees for their effort. Plaintiffs will also usually agree to dismiss the class claims without prejudice—meaning that another plaintiff could later file a similar lawsuit asserting claims for the same class, most likely post-closing. Dismissal of class claims without prejudice leaves the threat of litigation hanging over the company, because another plaintiff could, at any time, assert claims on an individual or class-wide basis, meaning that a court does not have the power to review and potentially reject the settlement as unfair.

In the 2016 case *In re Trulia*, the Delaware Court of Chancery said it would no longer approve disclosure-only settlements unless:

- the supplemental disclosures were "plainly material";
- the release of claims was limited in scope; and
- plaintiffs demonstrated that they adequately investigated any released claims.

Many observers thought that this standard would greatly reduce the number of M&A lawsuits because it eliminated the availability of "easy money" settlements (as one court termed them). And, indeed, it did reduce the number of such lawsuits filed in Delaware state court. But, in response, plaintiffs have shifted to asserting claims based on federal law instead of state law, alleging violations of SEC rules that prohibit false and misleading statements in proxy materials. In so doing, plaintiffs avoid the application of exclusive forum charter or bylaw provisions, which many Delaware companies have adopted and that require state law claims to be heard in the Delaware Court of Chancery.

Recently, however, two federal courts have questioned disclosure-only settlements in an apparent effort to exercise oversight and curb potential abuse.

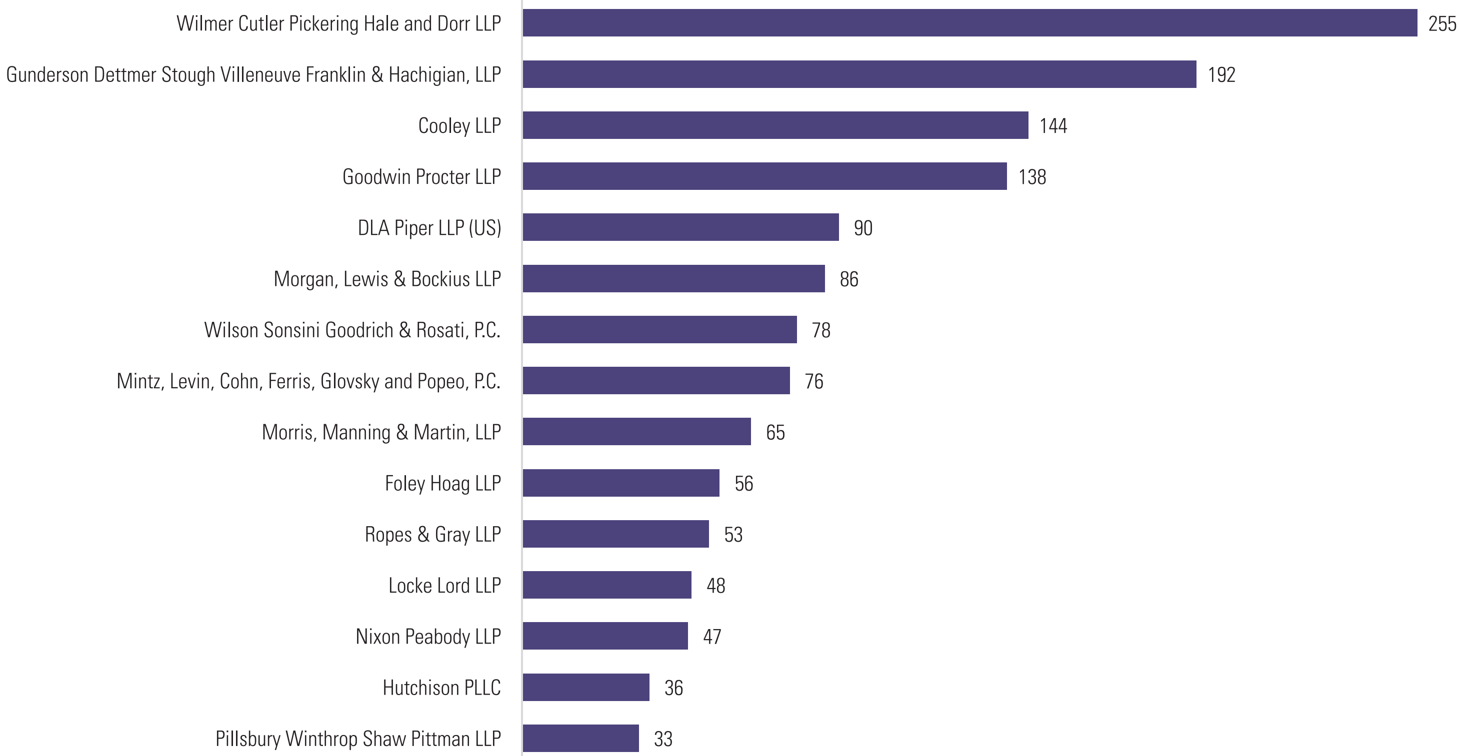
In the Southern District of New York, Judge Cote examined the potential for abuse in a suit alleging that Time, Inc. had omitted certain material information in its filings related to a tender offer by Meredith Corporation. Specifically, Judge Cote reviewed whether the Private Securities Litigation Reform Act (PSLRA) required her to review the pleadings to determine if plaintiffs filed the case for an improper purpose, i.e., to harass Time into paying a nuisance-fee settlement. The PSLRA requires this review where a securities claim is adjudicated on the merits. Judge Cote found, however, that dismissal of individual plaintiffs' claims with prejudice was not an adjudication on the merits within the meaning of the statute and thus did not merit such a review. Nonetheless, Judge Cote noted the "dangers inherent" in such suits and questioned whether a putative class may, before a lead plaintiff is appointed and class certified, even obtain preliminary injunctive relief in these types of cases (which would essentially disarm plaintiffs from threatening to delay or halt the deal before the shareholder vote).

More recently, in the Northern District of Illinois, Judge Durkin examined whether the voluntary dismissal of six separate suits against Akorn, Inc. constituted abuse. Each of the suits alleged that Akorn, Inc. had made certain omissions or misstatements in connection with Frensenius Kabi AG's bid to acquire the company. After Akorn made the requested disclosures, the parties agreed to dismiss the lawsuits and defendants agreed to pay plaintiffs' counsel's fees. But, before the court approved the settlement, a member of the class sought to intervene and object to the settlement. Although the court denied the motion to intervene, it nonetheless invoked its "inherent powers to police potential abuse of the judicial process—and abuse of the class mechanism in particular—[to] require plaintiffs' counsel to demonstrate that the disclosures for which they claim credit [were plainly material]"—the same disclosure standard applied by the Delaware Chancery Court in *Trulia*. The court noted that, should a plaintiff fail to meet this standard, the court would order plaintiff's counsel to disgorge the attorneys' fees back to Akorn.

To the extent defendants are still seeking class-wide releases as part of any disclosure-only settlement, Judge Alsup in the Northern District of California has suggested yet another approach to discourage such settlements. In any class action before him, he issues a standing order that generally prohibits the parties from "discuss[ing] settlement as to any class claims prior to class certification." The purpose of this rule is to force plaintiffs' counsel to investigate class claims thoroughly and thus avoid settling for less than the class deserves. He also generally requires that a release only extend to those who receive a monetary payment. The order is currently being challenged in an appeal to the Ninth Circuit as violating the parties' First Amendment rights to free speech. Were the Ninth Circuit to uphold the order, however, it could essentially prevent class-wide disclosure-only settlements in Judge Alsup's session.

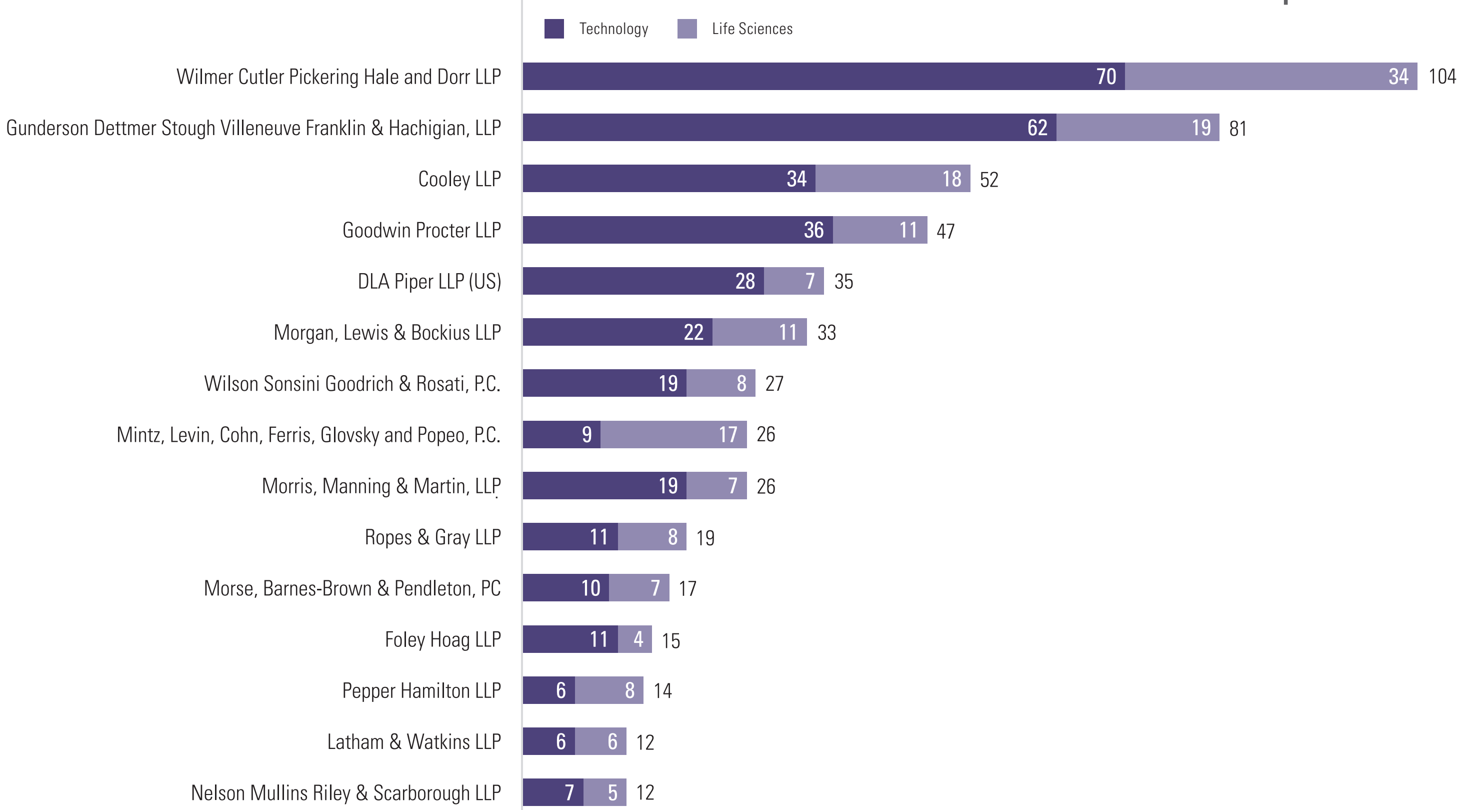
Given the economic incentives of both the plaintiff and defense bars (one wanting easy money, the other deal security), the courts may need to exercise their authority to stem this tide of nuisance litigation. Judges Cote and Durkin have sent a message with their recent opinions: federal courts will not sit idly by as their dockets are swamped with frivolous litigation that the Delaware Chancery Court has already turned away. Let's hope the plaintiffs are listening. ■

Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2018



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 2018



The above chart is based on VC-backed companies located east of the Mississippi River.
Source: Dow Jones VentureSource

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ThermoFisher SCIENTIFIC
Sale of anatomical pathology business to
PHC Holdings
$1,140,000,000
Pending
(as of April 30, 2019)

FORTIVE
Acquisition of
Gordian
$775,000,000
July 2018

Akamai
Acquisition of
Janrain
$125,000,000
January 2019

redhat
Acquisition of
CoreOS
$250,000,000
January 2018

CRANE&CO.
Acquisition by
Crane Co.
$800,000,000
January 2018

TMC
Acquisition by
Intercontinental Exchange
$685,000,000
July 2018

mks Technology for Productivity
Acquisition of
Electro Scientific Industries
$1,000,000,000
February 2019

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

Houghton Mifflin Harcourt. The Learning Company
Sale of Riverside clinical and standardized testing business to
Alpine Investors
$140,000,000
October 2018

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

POTENZA therapeutics
Acquisition by
Astellas Pharma
$405,000,000
(including contingent payments)
December 2018

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

KADANT AN ACCENT ON INNOVATION
Acquisition of
Syntron Material Handling Group
$179,000,000
January 2019

Progress
Acquisition of
Ipswitch
$225,000,000
April 2019

Lydall
Acquisition of Interface Performance Materials from
Wind Point Partners
$265,000,000
August 2018

PerkinElmer For the Better
Sale of medical imaging business to
Varian Medical Systems
$276,000,000
May 2017

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

B&S group
Acquisition of
FragranceNet.com
$115,000,000
October 2018

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

NAVIENT
Acquisition of
Earnest
$155,000,000
November 2017

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

PTC THERAPEUTICS
Acquisition of
Agilis Biotherapeutics
$200,000,000
August 2018

workmarket
Acquisition by
ADP
$125,000,000
January 2018

Braintree LABORATORIES, INC
Acquisition by
Sebela Pharmaceuticals
Undisclosed
May 2018

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

VAIL RESORTS EXPERIENCE OF A LIFETIME
Acquisition of
Triple Peaks
$237,000,000
September 2018

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

arsanis
Acquisition by
X4 Pharmaceuticals
$165,000,000
March 2019

adswizz MEASURE TARGET MONETIZE
Acquisition by
Pandora
$145,000,000
May 2018

wework
Acquisition of
Teem Technologies
Undisclosed
May 2018

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

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

wex
Acquisition of
Discovery Benefits
$425,000,000
March 2019

analogic
Acquisition by
Altaris Capital Partners
$1,100,000,000
June 2018

WILMERHALE®

The US government's interagency body known as the Committee on Foreign Investment in the United States (CFIUS) was originally established in 1988 to vet foreign investments and acquisitions with national security implications. In 2007, CFIUS's authority was expanded. Last year, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) further increased the power of CFIUS to review foreign investments in the United States that pose national security risks. Passage of FIRRMA reflects growing bipartisan concern that certain foreign transactions are diminishing US technological superiority and that CFIUS needs more authority and resources to review complex deal mechanisms used by foreign investors to acquire valuable stakes in US companies that are important for US security.

The new law makes substantial changes to the current CFIUS regime. Navigating deal risks associated with CFIUS will likely grow more complex going forward, for both US sellers and foreign buyers. FIRRMA allows CFIUS to analyze a greater range of transactions than before, empowers CFIUS to require certain investors to make mandatory filings, allows CFIUS for the first time to charge filing fees, and requires the Commerce Secretary to oversee the creation of new export control restrictions for emerging critical technologies. The law also attempts to create greater certainty for deal parties by requiring CFIUS to complete its work within 45 days, except in extraordinary circumstances.

FIRRMA requires the Secretary of the Treasury, who chairs CFIUS, to craft new regulations to implement many provisions of the law. The rulemaking process is likely to continue to play out through 2019 and beyond, with a variety of opportunities for companies to engage with the Treasury Department about the new regulations. In short, the passage of FIRRMA marked a milestone, but not the end, of the CFIUS reform process.

BROADENING THE SCOPE OF COVERED TRANSACTIONS

FIRRMA amends the Defense Production Act of 1950 by broadening the scope of "covered transactions" that are subject to CFIUS review and by adding or amending several key terms.

Under FIRRMA, covered transactions include not just any merger, acquisition or takeover by a foreign person that could result in foreign control of a US business—including those carried out through a joint venture—but also:

- any other investment by a foreign person in any US business that is involved in critical infrastructure or the production of critical technologies, or that maintains sensitive personal data that, if exploited, could threaten national security;
- any change in a foreign investor's rights regarding a US business where that change would result in foreign "control" of a US business or where the change involves critical infrastructure or critical technology companies;
- any other transaction, transfer, agreement or arrangement designed to circumvent or evade CFIUS; or
- the purchase, lease or concession by or to a foreign person of certain real estate in close proximity to military or other sensitive national security facilities.

Each of these provisions requires new regulations from the Treasury Department. In October 2018, CFIUS announced interim rules, effective November 10, 2018, to implement portions of FIRRMA through a so-called pilot program. These interim rules make two important changes to CFIUS for investments in companies that develop or produce critical technologies.

First, with some exceptions for investment funds, the pilot program expands the jurisdiction of CFIUS to capture any pilot program covered investment:

- *A pilot program covered investment* is any direct or indirect investment by a foreign person in a pilot program US business that does not result in control of the US business but affords the foreign person access to any material nonpublic technical information, or membership or observer rights on the board of the US business, or any other involvement in the operation of the US business's use of critical technologies (other than voting shares).
- *A pilot program US business* is any business that produces, designs, tests, manufactures, fabricates or develops a critical technology that is utilized in connection with the US business's activity in one or more pilot program industries or designed by the US business specifically for use in one or more pilot program industries.
- *Critical technologies* are broadly defined to include any company that develops or produces technology subject to US export restrictions.

Second, the pilot program mandates notification to CFIUS of any pilot program covered investment or any transaction where a foreign person acquires *control* of a pilot program US business. Through this rule, CFIUS is creating a regime where parties to transactions involving certain critical technologies must inform CFIUS about foreign investments. If parties do not notify CFIUS of a covered foreign investment in a pilot program US business, then CFIUS has the power to levy civil penalties up to the value of the transaction.

FIRRMA includes a special exception for limited partner investments in critical infrastructure or critical technology companies that will likely be of great importance to private equity funds and deal teams structuring complex transactions. Membership on an advisory board or investment committee as a limited partner or the equivalent in an investment fund investing in a critical technology or critical infrastructure company does not trigger CFIUS jurisdiction if the fund is managed by a general partner or equivalent; the general partner is not a foreign person; the advisory board or committee does not have the power to disapprove or control investment decisions of the fund or decisions made by the general partner; and the foreign person does not otherwise have any power to control the operations of the fund.

AMENDMENTS TO TIMING OF THE CFIUS REVIEW PROCESS

FIRRMA includes several provisions designed to expedite CFIUS reviews.

In light of a growing trend at CFIUS of parties encountering substantial delays initiating the review process, FIRRMA requires CFIUS to provide comments on filings or accept complete written notices within 10 business days of the submission of a case where the parties stipulate that the transaction is a covered transaction or that it is a foreign government–controlled transaction.

FIRRMA also changes the amount of time CFIUS has to complete the review process. Previously, CFIUS reviews could last as long as 75 calendar days (a 30-day review period plus a 45-day investigation period), and CFIUS sometimes demanded that parties withdraw and refile to start the clock anew. FIRRMA changes the timing for CFIUS's review process by extending the time available for the CFIUS review period from 30 to 45 calendar days. The 45-day clock for the investigation remains unchanged, but FIRRMA gives CFIUS authority to extend an investigation for an additional 15 calendar days in extraordinary circumstances. CFIUS is charged with crafting regulations to determine what constitutes such a circumstance. (In rare cases where a case is referred to the president, the president has an additional 15-day period to announce a decision about the transaction.)

UNILATERAL REVIEWS, SUSPENSION POWERS AND MITIGATION AGREEMENTS

FIRRMA clarifies the power of CFIUS to initiate its own reviews of transactions and its ability to stop a transaction from closing when CFIUS perceives a threat to national security that may require mitigation or result in a recommendation that the transaction be blocked. In particular, FIRRMA makes clear that CFIUS has the authority to suspend a transaction during a review or investigation if the transaction "may" pose a risk to the national security of the United States. This means that CFIUS now has expanded authority to stop parties from closing a transaction before CFIUS completes its review process.

The bill also grants CFIUS the authority to use mitigation agreements and conditions to address situations where the parties have chosen to abandon a transaction without a presidential order, as well as to impose interim mitigation agreements and conditions for national security risks posed by completed transactions while such transactions are undergoing CFIUS review.

ESTABLISHMENT OF NEW ASSISTANT SECRETARY OF THE TREASURY

The bill establishes a new Assistant Secretary for Investment Security at the Department of the Treasury. This official requires Senate confirmation and principally focuses on CFIUS work. The bill also directs each CFIUS member to designate an Assistant Secretary–level official to carry out CFIUS's duties.

REPORTS ON CHINA AND ON US RAIL ASSETS

FIRRMA requires that no later than two years after enactment, and every two years thereafter through 2026, the Secretary of Commerce must submit to Congress and CFIUS a report on foreign direct investment transactions made by Chinese entities in the United States.

It also requires a report to Congress, submitted not later than one year from the law's enactment, from the Secretary of Homeland Security assessing the national security risks related to investments in the manufacture and assembly of freight and passenger rail assets in the United States by foreign state-owned or state-controlled entities.

IMPLEMENTATION

FIRRMA directs the Secretaries of Treasury and Commerce, within 180 days of the law's enactment, to develop and submit implementation plans to Congress. The bill also directs the president to determine whether CFIUS's expanded responsibilities necessitate additional resources and, if so, to include a request for additional resources in future budgets. As of April 2019, no official plans to implement FIRRMA have been submitted to Congress and the president has yet to make the stipulated determination.

FILING FEE

FIRRMA authorizes CFIUS to charge companies filing CFIUS notices a filing fee of up to 1% of the transaction value or $300,000, whichever is less. Congress is authorized to appropriate $20 million to the fund for each fiscal year from 2019 through 2023.

EXPORT CONTROLS ACT OF 2018

FIRRMA repealed and replaced the Export Administration Act of 1979, which had lapsed and had been continued in effect by the International Emergency Economic Powers Act. Among the provisions of the new Export Controls Act of 2018 is a requirement for the Commerce Department to create new export restrictions on "emerging and foundational" technologies that are important to the defense community and are not otherwise captured under the US export control regime. Specifically, FIRRMA tasks the Secretary of Commerce and an interagency group to identify such technologies that are essential to national security and are not currently controlled under the International Traffic in Arms Regulations, multilateral controls regimes implemented by the Commerce Control List, or other relevant US regulations. The interagency group includes the Departments of Defense, Energy, State and Commerce, along with other agencies, as appropriate. Information relating to reviews and investigations of transactions by CFIUS may inform this interagency process. The Commerce Department is authorized to require that any license application for the export of emerging and foundational technologies identify "any foreign person with significant ownership interest in a foreign person participating in" a joint venture, joint development agreement or similar collaborative arrangement involved in an export transaction.

This provision is significant because FIRRMA negotiators hotly contested how best to address concerns about the export of emerging technologies to foreign competitors, particularly regarding the transfer of know-how for creating advanced technologies important to US national security. Congress chose to address those concerns by enhancing the export control regime rather than regulating through the CFIUS process. Companies developing or acquiring any advanced technology should be sensitive to these new export control provisions and consider how the CFIUS process and other interactions with the government could affect export control determinations. ■

A Comparison of Deal Terms in Public and Private Acquisitions

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 public company's SEC filing, may have higher materiality thresholds, and 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, in certain circumstances, to change the target board's recommendation to stockholders.

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

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

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

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

SEC INVOLVEMENT

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

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

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

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

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

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

Set forth on the following page is a comparison of selected deal terms in public target and private target acquisitions, based on the most recent studies available from SRS Acquiom (a provider of post-closing transaction management services) and the Mergers & Acquisitions Committee of the American Bar Association's Business Law Section. The SRS Acquiom study covers private target acquisitions in which it served as shareholder representative and that closed in 2018. The ABA private target study covers acquisitions that were completed in 2016 and the first half of 2017, and the ABA public target study covers acquisitions that were announced in 2016 (excluding acquisitions by private equity buyers).

COMPARISON OF SELECTED DEAL TERMS

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

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

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

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

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

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

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

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

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

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

Standard for Accuracy of Target Representations at Closing	
PUBLIC (ABA)	
"MAC/MAE"	99%
"In all material respects"	None
Other standard	1%
PRIVATE (ABA)	
"MAC/MAE"	48%
"In all material respects"	50%
"In all respects"	2%
PRIVATE (SRS ACQUIOM)	
"MAC/MAE"	48%
"In all material respects"	51%
"In all respects"	1%

Inclusion of "Prospects" in MAC/MAE Definition	
PUBLIC (ABA)	None
PRIVATE (ABA)	15%
PRIVATE (SRS ACQUIOM)	9%

Fiduciary Exception to "No-Shop/No-Talk" Covenant	
PUBLIC (ABA)	100%
PRIVATE (ABA)	11%
PRIVATE (SRS ACQUIOM)	4%

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

Appraisal Rights Closing Condition	
PUBLIC (ABA)	
All cash deals	4%
Part cash/part stock deals	11%
PRIVATE (ABA)	
All deals	57%
PRIVATE (SRS ACQUIOM)	
All deals	64%

Acquirer MAC/MAE Closing Condition	
PUBLIC (ABA)	100%
PRIVATE (ABA)	93%
PRIVATE (SRS ACQUIOM)	96%

TRENDS IN SELECTED DEAL TERMS

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

In transactions involving *public* company targets:

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

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

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

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

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

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

In transactions involving *private* company targets:

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

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

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

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

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

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

POST-CLOSING CLAIMS

SRS Acquiom has released a study analyzing post-closing claim activity in over 1,000 private target acquisitions in which it served as shareholder representative from 2014 through the second quarter of 2018. This study provides a glimpse into the hidden world of post-closing claims in private acquisitions:

— *Frequency of Claims*: 40% of all transactions had at least one post-closing indemnification claim (excluding purchase price adjustments) against the escrow. Claim frequency increased with transaction value, from 28% of deals valued at $50 million or less, to 55% of deals valued in excess of $500 million. Claims were most likely in deals with financial buyers (49% of transactions) and least likely in deals with US private buyers or foreign buyers (37% of transactions in each case).

— *Size of Claims*: Median claim size (excluding purchase price adjustments) as a percentage of the escrow ranged from a high of 127% for fraud claims to a low of 1% for capitalization claims. On average, claim size as a percentage of the escrow was highest on deals valued at $50 million or less and on deals with financial buyers, and lowest on deals valued in excess of $200 million and on deals with US public buyers.

— *Subject Matter of Claims*: Among all claims, the subject matter consisted of breaches of representations and warranties (49%), purchase price adjustments (28%), transaction fees/costs (20%), appraisal rights (1%) and fraud (1%).

— *Bases for Misrepresentation Claims*: Most frequently claimed misrepresentations involved tax (45%), capitalization (12%), employee-related (11%), undisclosed liabilities (9%), intellectual property (8%), financial statements (7%), regulatory compliance (3%) and customer contracts (3%).

— *Resolution of Claims*: Contested claims were resolved in a median of 2.1 months. Regulatory claims took the most time to be resolved (median of 13 months), while fraud claims were resolved the quickest (median of one month).

— *Purchase Price Adjustments*: 82.5% of all transactions had mechanisms for purchase price adjustments. Of these, 74% had a post-closing adjustment (favorable to the buyer in 42% of transactions and favorable to target stockholders in 32% of transactions).

— *Expense Fund*: Median size of $200,000 (0.24% of transaction value).

Buyers or sellers of companies can purchase representation and warranty insurance (R&W insurance) to provide coverage for indemnification claims arising from the seller's misrepresentations. Although this type of insurance is not new, its use has grown in recent years—particularly in sales of privately held companies backed by venture capital or private equity investors. As with other forms of insurance, R&W insurance policies have deductibles, coverage limits, exclusions and policy periods. Premiums typically range from 2% to 4% of the coverage limit.

The presence of R&W insurance in a private company sale influences the negotiated outcomes of various provisions in the acquisition agreement, most notably the seller's representations and warranties and liability provisions.

Below is a summary of the principal effects on transaction terms when buy-side R&W insurance is present, based on an analysis conducted by SRS Acquiom of 588 private-target acquisitions that closed from 2015 through 2017, in which SRS Acquiom provided professional and financial services. In its study, called the *Buy-Side Representations and Warranties Insurance (RWI) Deal Terms Study*, SRS Acquiom noted that the reported effects of buy-side R&W insurance on deal terms are likely understated due to data limitations.

DEAL CHARACTERISTICS

— Buy-side R&W insurance is more common when the deal size exceeds $50 million. In the study's sample, the median size of transactions with buy-side R&W insurance was $101.8 million, compared to $62.8 million in other transactions.

— Among deals involving publicly held buyers, the less leverage the buyer has relative to the seller (measured by the ratio of the buyer's market capitalization to the transaction value), the higher the probability that the buyer will purchase R&W insurance.

FINANCIAL TERMS

— Indemnification escrows are significantly smaller (or eliminated entirely) when buy-side R&W insurance is present, with a median size of just 1%, compared to 10% in other deals.

— Deals with buy-side R&W insurance are more likely than other deals to contain a purchase price adjustment mechanism (by a margin of 92% to 82%), with an overwhelming preference to rely on a separate escrow to secure the purchase price adjustment (82% of deals with buy-side R&W insurance, compared to 29% of other deals).

REPRESENTATIONS AND WARRANTIES

— A "10b-5" or "full disclosure" representation—to the effect that the seller's representations and warranties are complete, accurate and not misleading—is absent from 82% of deals with buy-side R&W insurance, compared to 58% of other deals. Similarly, provisions to the effect that the seller is making no representations except as set forth in the acquisition agreement are more likely to be present in deals with buy-side R&W insurance than other deals (by a margin of 85% to 64%).

— "Pro-sandbagging" provisions, allowing a party to seek indemnification for the other party's misrepresentations even if the non-breaching party knew of the misrepresentations prior to closing, are present in 32% of deals involving buy-side R&W insurance, compared to 56% of other deals.

— "Materiality scrapes," providing that materiality qualifications in representations and warranties are disregarded for purposes of determining both breaches and damages, appear in 54% of deals with buy-side R&W insurance, but only 30% of other deals.

— The acquisition agreement is less likely to require the seller to notify the buyer of pre-closing breaches of representations and warranties when buy-side R&W insurance is present (60%) than in other deals (78%).

— In deals with buy-side R&W insurance, the forward-looking language in the definition of material adverse change/effect is the seller-favorable "would be" formulation in 85% of deals and the "could be" formulation in 11% of deals. Among other deals, 64% use the "would be" formulation and 19% use the "could be" formulation.

LOSS MITIGATION AND SETOFFS

— When buy-side R&W insurance is present, the acquisition agreement is more likely than in other deals to require the buyer to mitigate losses (by a margin of 76% to 44%) and offset losses against any recovery from insurance (by a margin of 96% to 84%) or tax benefits (by a margin of 54% to 32%).

— Among deals with earnouts, 61% involving buy-side R&W insurance expressly permit buyers to offset indemnification claims against future earnout payments, compared to 84% of other deals, and 33% of deals with buy-side R&W insurance expressly prohibit such offsets, compared to only 6% of other deals.

— In deals with buy-side R&W insurance, the seller's indemnification obligations are more likely to be structured as a "deductible basket," in which the seller is liable only for damages in excess of a specified threshold amount (67% of deals), than a "tipping basket," in which the seller is liable for all damages once the threshold amount has been reached (22% of deals). By contrast, in other deals, the seller's indemnification obligations are structured as a "deductible basket" in 38% of deals and as a "tipping basket" in 56% of deals.

DISPUTE RESOLUTION

— A conflict waiver provision allowing the sell-side law firm to represent the seller post-closing is present in 74% of deals with buy-side R&W insurance, compared to 57% of other deals.

— The parties specify an alternative dispute resolution mechanism in only 11% of deals with buy-side R&W insurance, compared to 31% of other deals.

— The parties waive jury trials in 90% of deals involving buy-side R&W insurance, compared to 72% of other deals. ■

Trends in VC-Backed Company M&A Deal Terms

We reviewed all merger transactions between 2011 and 2018 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		2011	2012	2013	2014	2015	2016	2017	2018
The number of deals we reviewed and the type of consideration paid in each	Sample Size	51	26	27	37	27	19	18	37
	Cash	73%	73%	59%	59%	67%	47%	56%	84%
	Stock	4%	8%	8%	3%	4%	0%	0%	3%
	Cash and Stock	23%	19%	33%	38%	29%	53%	44%	13%
Deals with Earnout		**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Deals that provided contingent consideration based upon post-closing performance of the target (other than balance sheet adjustments)	With Earnout	29%	31%	33%	30%	26%	37%	22%	32%
	Without Earnout	71%	69%	67%	70%	74%	63%	78%	68%
Deals with Indemnification		**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
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	98%	100%	100%	97%	100%	100%[1]	94%[2]	84%
	By Buyer	43%	62%	44%	49%	69%	37%	61%	39%
Survival of Representations and Warranties		**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Length of time that representations and warranties survived the closing for indemnification purposes (subset: deals where representations and warranties survived the closing for indemnification purposes)[3]	Shortest	12 Mos.	10 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.	9 Mos.	12 Mos.
	Longest	24 Mos.	24 Mos.	30 Mos.	24 Mos.	24 Mos.	18 Mos.	24 Mos.	24 Mos.
	Most Frequent	18 Mos.	18 Mos.	18 Mos.	12 & 18 Mos. (tie)	18 Mos.	18 Mos.	12 Mos.	18 Mos.
Caps on Indemnification Obligations		**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Upper limits on indemnification obligations where representations and warranties survived the closing for indemnification purposes	With Cap	100%	100%	100%	100%	100%	100%	100%	100%
	Limited to Escrow	77%	81%	88%	89%	79%	83%	94%[5]	79%
	Limited to Purchase Price	2%	0%	0%	0%	0%	0%	0%	0%
	Exceptions to Limits[4]	96%	96%	100%	100%	100%	95%	94%	100%
	Without Cap	0%	0%	0%	0%	0%	0%	0%	0%

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

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

3 Measured for representations and warranties generally; specified representations and warranties may survive longer.

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

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

Escrows		2011	2012	2013	2014	2015	2016	2017	2018
Deals having escrows securing indemnification obligations of the target's shareholders (subset: deals with indemnification obligations of the target shareholders)	With Escrow	96%	100%	93%[6]	100%	93%	89%	100%	90%[6]
	% of Deal Value								
	Lowest[7]	5%	5%	5%	2%	4%	5%	4%	3%
	Highest	31%	16%	20%	16%	16%	15%	13%	15%
	Most Frequent	10%	10%	10%	10%	10%	10%	5%	10%
	Length of Time								
	Shortest	12 Mos.	10 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.	9 Mos.	12 Mos.
	Longest	36 Mos.	48 Mos.	30 Mos.	24 Mos.	36 Mos.	24 Mos.	24 Mos.	36 Mos.
	Most Frequent	18 Mos.	12 Mos.	18 Mos.	12 Mos.	12 & 18 Mos. (tie)	18 Mos.	12 & 18 Mos. (tie)	18 Mos.
	Exclusive Remedy	78%	73%	60%	86%	63%	88%	71%	72%
	Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy[4]	97%	100%	100%	100%	100%	93%	92%	100%

Baskets for Indemnification		2011	2012	2013	2014	2015	2016	2017	2018
Deals with indemnification only for amounts above a specified "deductible" or only after a specified "threshold" amount is reached	Deductible[8]	38%	27%	50%	44%	31%	47%	63%	47%
	Threshold[8]	60%	65%	42%	56%	61%	53%	37%	53%

MAE Closing Condition		2011	2012	2013	2014	2015	2016	2017	2018
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	98%	95%	100%	97%	100%	100%	94%	100%
	Condition in Favor of Target	15%	9%	17%	19%	12%	39%	22%	12%

Exceptions to MAE		2011	2012	2013	2014	2015	2016	2017	2018
Deals where the definition of "material adverse effect" for the target contained specified exceptions	With Exception[9]	94%[10]	84%[11]	96%[12]	100%	100%	100%	100%	97%[12]

6 One transaction not including an escrow at closing did require funding of escrow with proceeds of earnout payments.

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

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

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

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

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

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

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

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