# 2008 M&A Report

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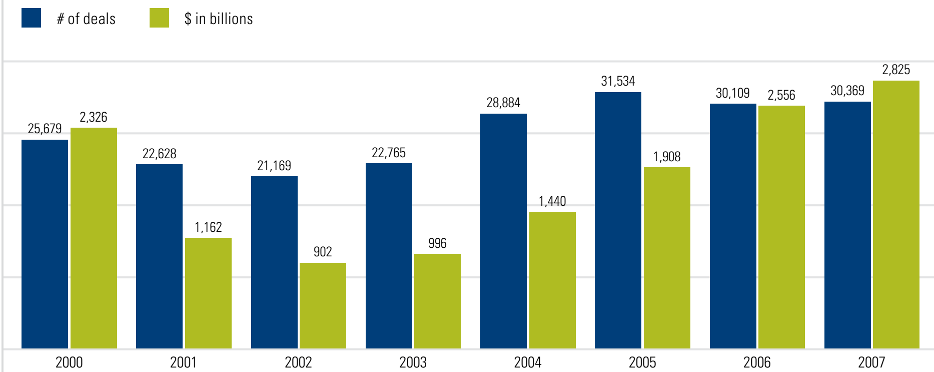
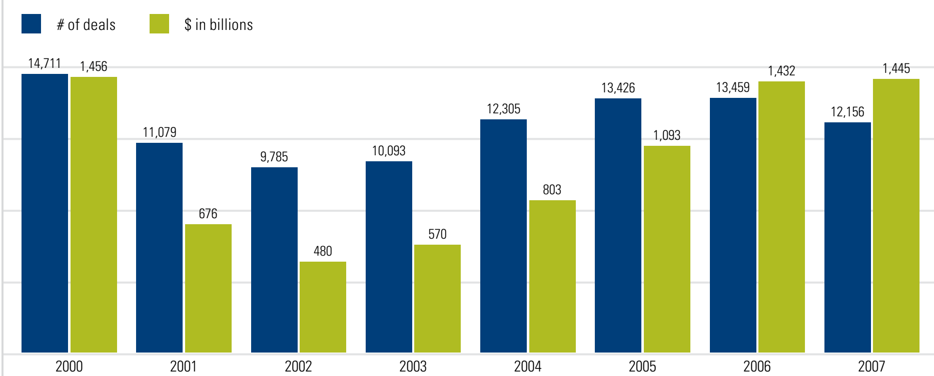



*Source: MergerStat*

### M&A Activity – United States




*Source: MergerStat*

**2007 Review**

2007 was another record year for mergers and acquisitions. While global M&A transaction deal volume increased only slightly, from 30,109 reported transactions in 2006 to 30,639 in 2007, deal value increased by 10% to reach $2.84 trillion in 2007, up from a previous record $2.56 trillion in 2006. The largest M&A transaction of 2007 was the acquisition of the global banking group ABN AMRO by RFS Holdings B.V. for $95.6 billion.

Average deal size based on all M&A transactions worldwide in which the price was disclosed increased to $218.6 million in 2007 from $194.2 million in 2006. Although the number and average size of deals increased from the prior year, deal flow dropped by 3% from the first half to the second half of 2007. Average deal size in the second half of 2007 fell by one fourth, slipping to $186.9 million from $250.7 million in the first half of the year.

US M&A results were somewhat more mixed than global results. The volume of US M&A activity decreased by 10%, from 13,459 transactions in 2006 to 12,156 in 2007. Deal value edged up, from $1.43 trillion to $1.45 trillion, but trailed the worldwide increase of 10%. Of the total deal value, $452 billion was produced in the second quarter. Average US deal size increased to $316.7 million in 2007 from $263.8 million in the prior year.

In Europe, both deal volume and deal value were higher in 2007 than 2006. Deal volume increased 8%, from 11,872 in 2006 to 12,863 in 2007, while deal value soared by 28%, from $1.16 trillion to $1.49 trillion. Average deal size clocked in at $330.4 million, up from $261.7 million the prior year.

The Asia-Pacific region enjoyed continued growth in deal volume and value. The number of Asia-Pacific deals increased 5%, from 8,935 in 2006 to 9,340 in 2006, while the aggregate deal volume increased by 20%, from $458 billion to $551 billion. Average deal size increased from $87.0 million to $98.4 million.

The increases in average deal size were primarily due to the 12% jump in the number of billion-dollar transactions worldwide. 2007 saw 511 billion-dollar transactions, up from 455 the prior year. The aggregate value of all billion-dollar deals also increased 12%, from $1.77 trillion (69% of total global deal value) to $1.98 trillion (70% of total global deal value). The number of billion-dollar transactions in the United States increased 15%, from 251 in 2006 to 289 in 2007. Aggregate US billion-dollar deal value increased 2%, from $1.02 trillion in 2006 (71% of total US deal value) to $1.04 trillion in 2007 (72% of total US deal value). Billion-dollar transactions involving European companies experienced the strongest growth, with the number of transactions increasing 20%, from 220 in 2006 to 263 in 2007, and aggregate deal value increasing 36%, from $826 billion to $1.13 trillion. Among Asia Pacific companies, the number of billion-dollar transactions jumped 12%, from 89 in 2006 to 100 in 2007, with aggregate deal value increasing 20%, from $254 billion to $306 billion.

Private equity continued to play an important role in M&A activity in 2007. Fifty percent of the largest M&A

transactions were completed by private equity firms, including the acquisitions of Harrah's Entertainment, HCA and Equity Office Properties Trust. Reported deal activity by private equity firms slowed substantially in the second half of 2007, however, as worldwide deal value dropped from $599 billion in the first half of the year to $265 billion in the second half of the year, and US deal value plunged from $337 billion to $123 billion. In the fourth quarter of 2007, the value of private equity-backed deals was only $95 billion worldwide and $20 billion in the United States.

*Sector Analyses*

As in 2006, much of the strength of the 2007 M&A market can be attributed to deal activity in the financial services sector and several technology sectors.

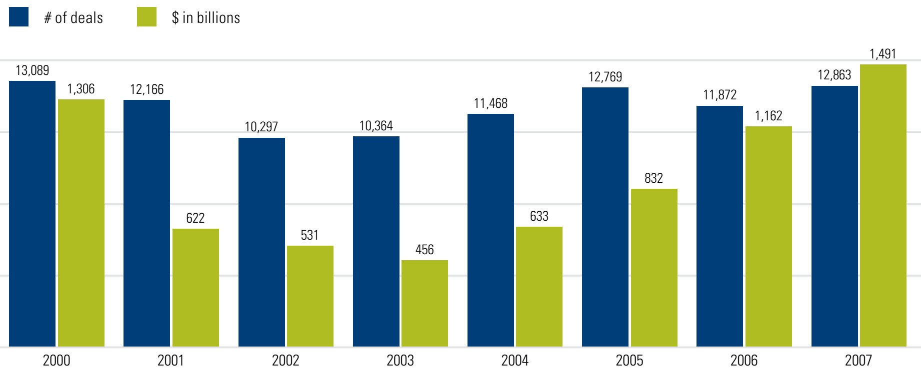
The global financial services sector saw a 3% decrease in deal volume, from 1,664 in 2006 to 1,612 in 2007. Aggregate global financial services sector deal value, however, increased 28%, from $323 billion to $413 billion, led by RFS Holdings B.V.'s $95.6 billion acquisition of ABN AMRO.

In the United States, financial services sector deal volume decreased 15%, from 726 deals in 2006 to 619 deals in 2007, while aggregate deal value increased from $148 billion to $151 billion. Bank of America's acquisition of LaSalle Bank for $21.0 billion was the largest US financial services sector deal of the year.

In the technology sector, the total number of IT deals decreased 3%, from 4,072 in 2006 to 3,951 in 2007. However, global IT deal value increased almost 45%, from $104 billion to $150 billion, led by the $27.0 billion acquisition of First Data Corp. by Kohlberg Kravis Roberts. US IT deal volume decreased 7%, from 2,307 in 2006 to 2,154 in 2007. Aggregate US IT deal value jumped 50%, however, from $75 billion to $113 billion.

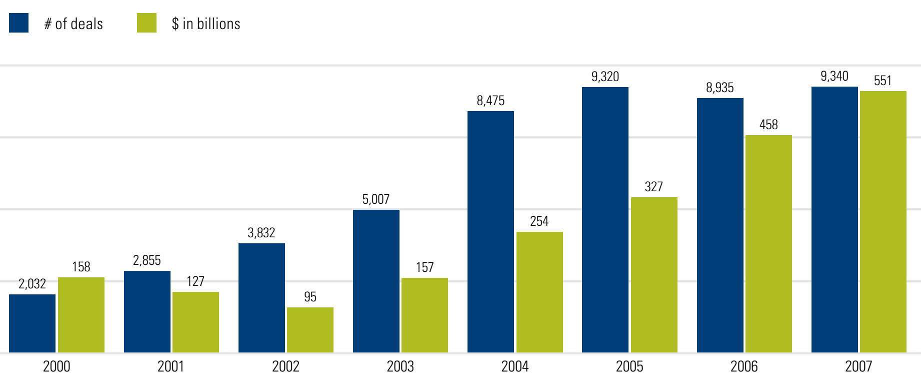
Deal volume and deal value in 2007 declined in the telecommunications sector. Global deal volume was down 3%, from 1,078 in 2006 to 1,041 in 2007, while US deal volume fell by 10%, from 457 to 410. Global telecommunications

**M&A Activity – Europe**




Source: MergerStat

**M&A Activity – Asia-Pacific**




Source: MergerStat

deal value decreased 15%, from $227 billion to $189 billion. US aggregate telecommunications deal value plummeted by 45%, from a record $157 billion in 2006 to $86 billion in 2007.

Global M&A transaction activity in the life sciences sector decreased by 5%, from 1,071 in 2006 to 1,020 in 2007. Global life sciences deal value, however, increased 27%, from $140 billion to $178 billion, led by Tyco's $24.4 billion spin-off of Covidien. The volume of US life sciences sector deals decreased 8%, from 554 in 2006 to 512 in 2007, but aggregate US life sciences deal value increased 43%, from $79 billion to $113 billion.

The M&A market for US venture-backed companies was stronger in 2007 than in 2006. There were 398 reported acquisitions of venture-backed companies in 2007, compared to 420 in 2006, but the data will likely show a small increase once all 2007 transactions are reported. While the number of acquisitions did not change significantly in 2007, the purchase prices did. The median acquisition price for venture-backed companies jumped 83%, from $53 million in 2006 to $97 million in 2007. This represents both the fifth consecutive annual increase in the median acquisition price and, by a wide margin, the highest figure of any year other than 2000 (when the median acquisition price was $100 million).

The median acquisition price for US venture-backed companies in 2007 got a boost from some very large sales. In 2007, there were 11 acquisitions of venture-backed companies that hit the $500 million mark, compared to just three deals of this size in 2006. The largest announced deals of 2007 were Reliant Pharmaceuticals' acquisition by GlaxoSmithKline for $1.65 billion and the sale of EqualLogic to Dell for $1.4 billion.

The median amount raised by US venture-backed companies prior to acquisition was unchanged at $21.5 million, from 2006 to 2007, but the median time from initial funding to acquisition increased from 6.0 years to 6.7 years. When combined with the large increase in median acquisition prices, this meant that venture capitalists earned better returns in 2007, but had to wait a bit longer for them.

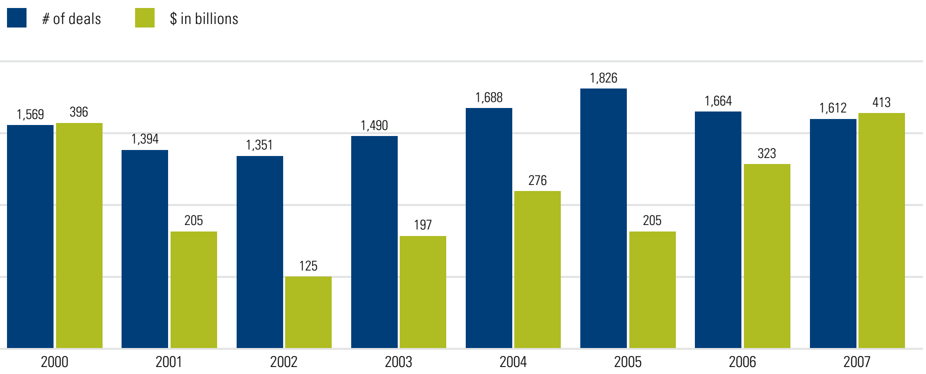
**2008 Outlook**

The strong M&A results of the past few years can be attributed to a variety of factors, including:

- the overall strength of the US and world economies;
- increased corporate profits and cash balances among buyers;
- stable debt and equity markets;
- the desire of strategic buyers to acquire new technologies and gain market share;
- the abundance of private equity money;
- interest rates that were low by historical standards; and
- in the case of VC-backed private companies, less favorable IPO conditions coupled with more attractive sale valuations.

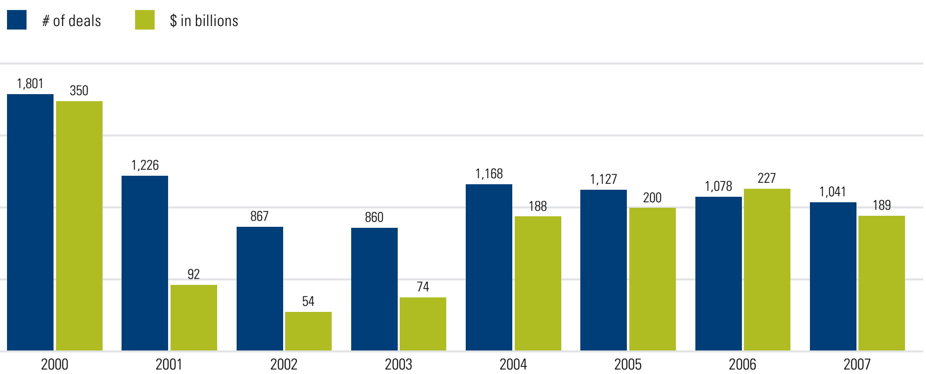
The outlook for 2008 is markedly less positive. The credit crunch that began in 2007 has deepened and shows no

**M&A Activity – Financial Services**



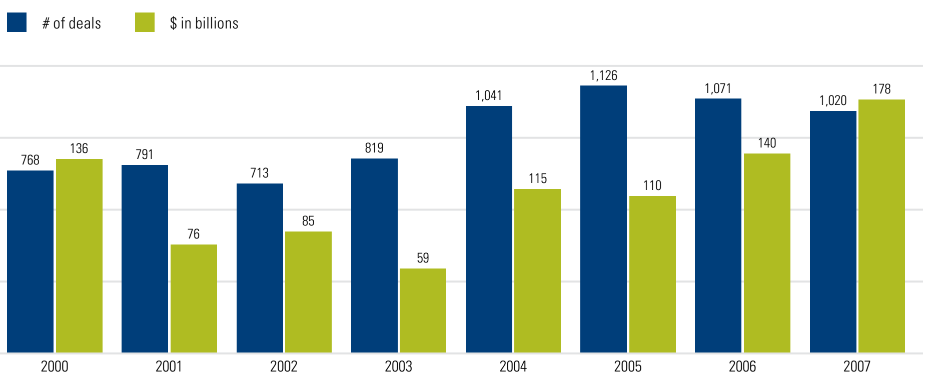

*Source: MergerStat*

**M&A Activity – Telecommunications**




*Source: MergerStat*

**M&A Activity – Life Sciences**




*Source: MergerStat*

signs of improving in the near term. As a result, the large private equity–backed transactions that drove M&A activity in 2006 and the first half of 2007 have dropped off dramatically. The dollar volume of reported private equity–backed transactions in the United States was 80% lower in the fourth quarter of 2007 and the first quarter of 2008 than in 2006 and the first three quarters of 2007, and declined by 65% worldwide. While more modest-sized, middle market private equity transactions may continue, the scarcity of debt will require greater equity contributions by investors, thereby limiting the prices those investors will be able to offer.

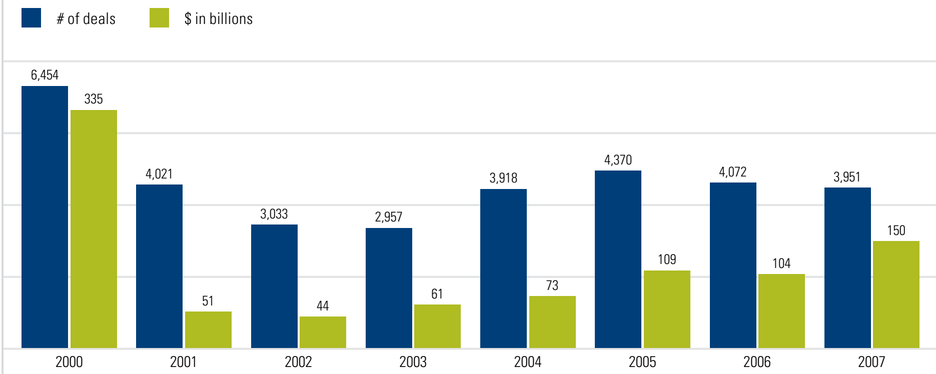
Weakening economic conditions also cloud the M&A outlook for the balance of 2008. Adverse economic factors include record-high petroleum prices and rising food prices worldwide, coupled in the US with the continuing decline in the housing market, the persistence of some core inflation, and the expense of continuing overseas military conflicts.

The credit crunch and gloomy economic forecast are also expected to impact strategic purchasers for much of 2008. If potential acquirors expect a recession, they may elect to conserve cash or available credit and forego M&A transactions. Moreover, there is often a lag between a seller's willingness to accept a lower transaction price and the lowered prices being offered by purchasers in light of less optimistic economic assumptions.

For many private companies, an M&A transaction will remain the exit vehicle of choice in 2008, given the demanding standards of the IPO market and the diminished appeal of being a public company in the face of increased regulatory burdens. The robust valuations enjoyed by sellers of venture capital–backed companies in 2007, however, may decline if strategic buyers pull in their reins.

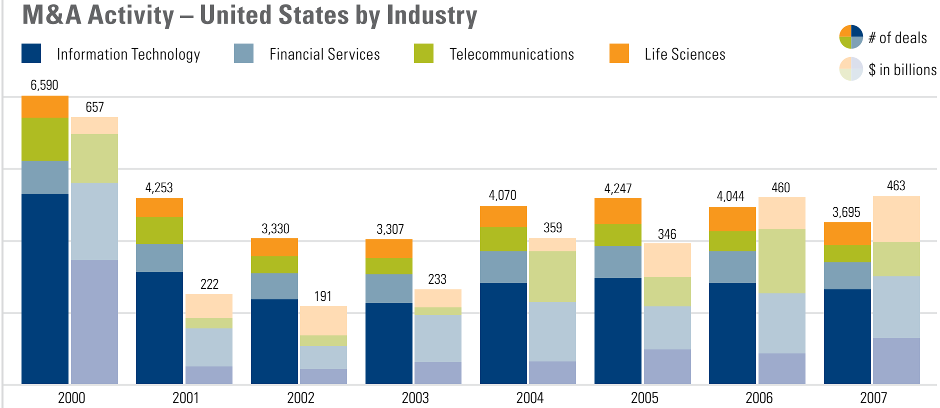
While it is difficult to predict the impact of all of these factors, it is reasonable to expect a pause in M&A activity. The outlook beyond 2008 will largely depend on the health of the credit markets and the strength of the economy as a whole. ■

## M&A Activity – Information Technology



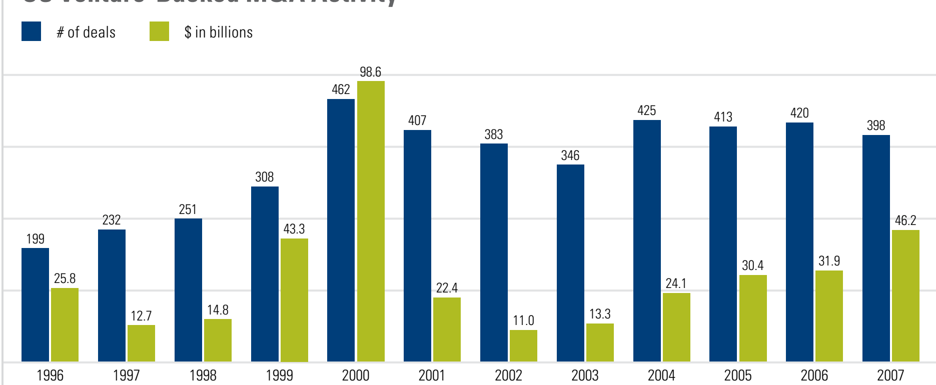

Source: MergerStat

## M&A Activity – United States by Industry




Source: MergerStat

## US Venture-Backed M&A Activity




Source: Dow Jones VentureOne

In recent years, the boards of directors of many public companies have dismantled a number of the corporate governance and anti-takeover provisions that were considered standard just a short time ago—either in response to direct pressure from stockholders, or on their own initiative in the spirit of conforming to "best practices" advocated by influential stockholders and proxy advisory services.

The rubber may soon hit the road, however, as a recent wave of unsolicited takeover bids—including several by well-known, well-regarded companies—combined with the lingering threat of being put in play by aggressive hedge funds, may cause boards to question whether the changes have gone too far.

**Where Have All the Defenses Gone?**

The speed with which anti-takeover defenses have come down has been staggering.

*Board Declassification* – According to data from RiskMetrics Group's Governance Institute, which was previously known as Institutional Stockholder Services, or ISS, at year end only 40% of S&P 500 companies had classified boards, down from 60% in 2003. On classified boards, directors are elected to serve staggered three-year terms so that only one-third of the board stands for re-election at each annual meeting. Looking more broadly at the S&P 1500, classified boards still represented a majority at the end of 2007, but barely so, at 52%—down from 63% in 2003. Stockholder proposals submitted under SEC Rule 14a-8 demanding board declassification routinely win 60% or more support based on votes cast. As fewer and fewer of the largest companies have staggered boards, the expectation is that investors will push mid- and small-cap companies to follow suit, even though these companies face significantly greater takeover risk due to their more digestible market capitalizations.

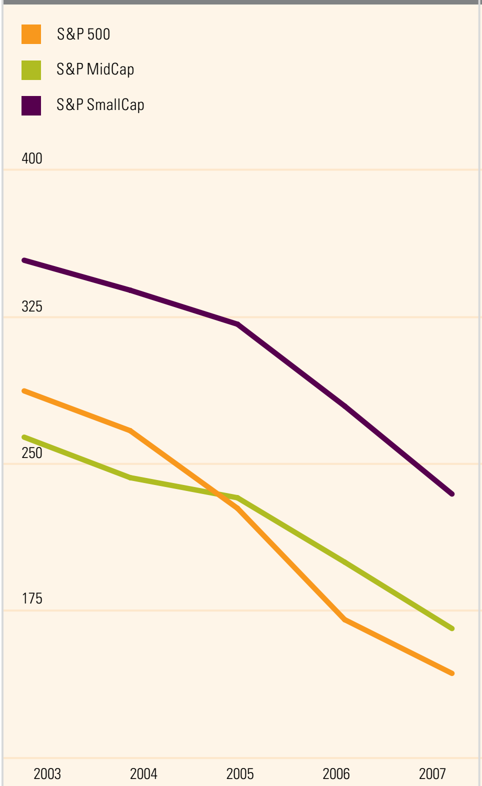
*Majority Voting* – The plurality voting standard for uncontested elections of directors has been under even greater attack. The majority vote movement, which has been championed by labor unions and other investors, is based on the premise that the plurality standard is fundamentally unfair in uncontested elections because nominees are guaranteed to be elected even if they receive only a single vote. Over 550 companies have adopted some form of majority voting, compared to virtually none in 2005. The full ramifications of majority voting on the composition and functioning of boards are yet to be seen, as few companies have thus far faced a situation in which a director has failed to receive a majority vote. It also remains to be seen how other potential regulatory changes may affect the way in which boards are elected, including:

- the proposed elimination of broker discretionary voting in uncontested elections, which would result in the loss of many automatic "for" votes that company nominees now receive;
- potential SEC action to implement some form of proxy access, whereby stockholders are authorized to name their own director nominees in the company's proxy statement; and
- recent SEC rules that expand the role of electronic communications, including e-proxy and electronic stockholder forums.

One of the most significant implications of the majority vote movement may be how it increases the likelihood that boards will act upon other stockholder proposals that are submitted under Rule 14a-8. Rule 14a-8 creates a procedure by which a holder of $2,000 or more in market value of company stock can submit either binding or advisory proposals that must be included in the company's proxy statement. Under its policy, RiskMetrics Group will recommend withholding votes from a director if the board fails to act on a stockholder proposal that was approved by a majority of the votes cast for the previous two consecutive years, or a majority of the shares outstanding in the previous year.

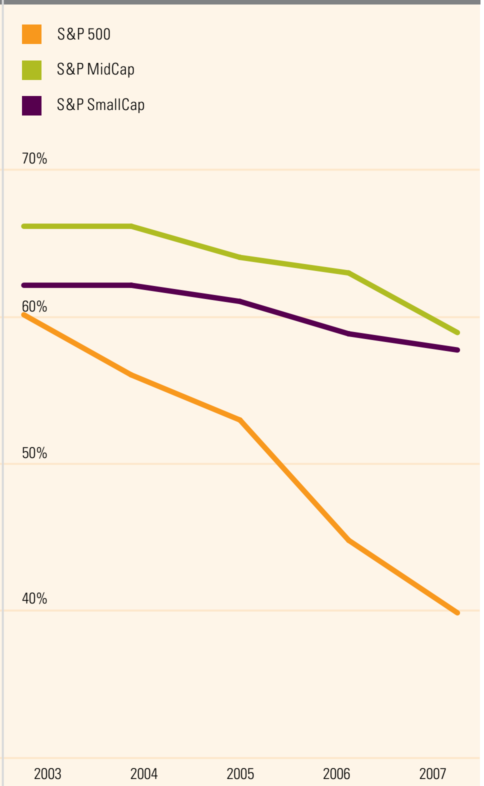
A majority vote standard adds teeth to the threat of a withhold vote, thereby reducing the willingness of some directors to resist stockholder proposals that are approved,

**Rights Plans in Effect – 2003 to 2007**




Source: SharkRepellent.net

**Companies with Classified Boards – 2003 to 2007**



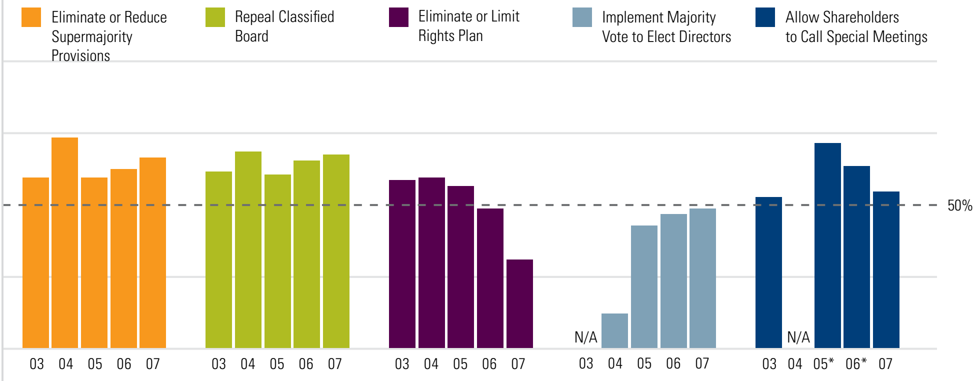

Source: RiskMetrics Group's Governance Institute even if the wisdom of the proposal is uncertain or the vote in favor would not be sufficient to effect the requested change had the proposal been binding. A majority vote standard also increases the likelihood that corporate governance changes that are the subject of Rule 14a-8 proposals will be implemented.

*Rights Plans* – Because of changes to RiskMetrics Group's voting policy that now result in a withhold vote against directors at companies that adopt or renew rights plans without stockholder approval, and due to the success of stockholder proposals requesting that rights plans be eliminated, many companies have decided to terminate their rights plans early or allow them to expire without renewal. In most cases, companies have retained the ability to reinstate a rights plan in the future, but some companies have adopted policies that commit to putting any future rights plan to a stockholder vote within one year. Of the companies that had rights plans that were scheduled to expire in 2007, over two-thirds allowed their plans to expire without renewal. Recent survey data indicates that the number of companies with active rights plans is below 30%. The number of S&P 500 companies with a rights plan in place is now about half what it was in the peak year of 2001, and the number of S&P 1500 companies with a rights plan in place is about 40% below the peak in 2002.

*Supermajority Vote Requirements* – Stockholder proposals seeking to eliminate supermajority vote provisions routinely win 65% or more support based on votes cast, making them the top vote-getting proposals in 2007, according to RiskMetrics Group data (followed by board declassification proposals). RiskMetrics Group data indicates that, as of December 2007, approximately two-thirds of companies in a broad index of over 5,000 companies allowed a simple majority vote to approve mergers, and that nearly half of those companies allowed a simple majority to amend the company's charter and bylaws.

*Limitations on Stockholders Calling Special Meetings* – Stockholder proposals to allow stockholders to call special meetings won majority support based on votes cast at 12 of the 18 companies where the proposal was voted on in 2007. RiskMetrics Group data indicates that, as of December 2007, approximately 46% of companies in a broad index of over 5,000 companies allowed stockholders to call special meetings.

**Votes "For" Governance Related Proposals – 2003 to 2007**




* Reflects vote at one company Source: Georgeson

### Have Things Gone Too Far?

Recent takeover activity highlights the continuing relevance of the provisions discussed above, and the importance of keeping in mind the underlying reasons for these provisions.

Staggered boards promote continuity and stability to help companies focus on long-term strategic planning, and resist a short-term focus. This is especially important when companies confront proxy contests launched by short-term investors seeking to take advantage of temporary blips affecting a company's market valuation or seeking to impose financial engineering strategies, such as significantly increasing the company's leverage without regard to the long-term risks.

Staggered boards also enhance the knowledge, experience and expertise of the board, by ensuring that at any time a majority of the directors will have had prior experience and familiarity with the company's business.

Many of these provisions enhance a board's ability to negotiate favorable deal terms on behalf of all of a company's stockholders, and to protect minority stockholders from coercive or partial bids to acquire the company.

These provisions also provide time for a company to evaluate the adequacy and fairness of takeover offers and to seek alternative transactions that may be more favorable to stockholders. This is especially important given the speed with which a tender offer can be consummated, and the fact that depressed stock levels allow bidders to appear to offer a significant premium, when in fact the offer price is low compared to trading prices over a longer period of time.

Supermajority provisions, in particular, are intended to help maximize the value of a company for all stockholders by ensuring that important protective provisions are only eliminated based on the clear will of the stockholders.

### Getting the Balance Right

The almost automatic adoption of certain corporate governance and anti-takeover provisions in the past was as inadvisable as today's seemingly inevitable march to remove those provisions. What companies and their stockholders need and deserve, rather than adherence to a master checklist that defines provisions as either good or bad, is a more tailored, good-faith analysis of what makes sense given a particular company's business, stage of development, market capitalization and character. ■

# Counsel of Choice for Mergers and Acquisitions

SERVING INDUSTRY LEADERS IN TECHNOLOGY, LIFE SCIENCES, FINANCIAL SERVICES, COMMUNICATIONS AND BEYOND

**EqualLogic**
*acquisition by*
Dell
**$1,400,000,000**
**January 2008**

**Kronos**
*acquisition by*
Hellman & Friedman
**$1,800,000,000**
**June 2007**

**Danaher**
*acquisition of*
Tektronix
**$2,800,000,000**
**November 2007**
(co-counsel)

**Akamai**
*acquisition of*
Netli
**$162,000,000**
**March 2007**

**PerkinElmer**
*acquisition of*
ViaCell
**$300,000,000**
**November 2007**

**Applix**
*acquisition by*
Cognos
**$339,000,000**
**October 2007**

**State Street**
*acquisition of*
Currenex
**$564,000,000**
**March 2007**

**Keane**
*acquisition by*
Caritor
**$854,000,000**
**June 2007**

**Thermo Fisher Scientific**
*acquisition of*
Priority Air Holdings
**$165,000,000**
**October 2007**

**Witness Systems**
*acquisition by*
Verint Systems
**$1,076,000,000**
**May 2007**

**Teradyne**
*acquisition of*
Nextest Systems
**$325,000,000**
**January 2008**

**TUI**
*merger of tourism division with*
First Choice Holidays
**£3,000,000,000**
**September 2007**
(German corporate and securities law counsel and antitrust co-counsel)

**454 Life Sciences**
*acquisition by*
Roche
**$140,000,000**
**May 2007**

**SkillSoft**
*acquisition of NETg from*
Thomson
**$285,000,000**
**May 2007**

**Glonav**
*acquisition by*
NXP Semiconductors
**$110,000,000**
(including earnout)
**January 2008**

**Analog Devices**
*sale of cellular handset radio and baseband chipset assets to*
MediaTek
**$350,000,000**
**January 2008**

**Domantis**
*acquisition by*
GSK
**£230,000,000**
**January 2007**

**HSBC**
*sale of Wealth & Tax Advisory Services USA in management buyout*
**$66,000,000**
**December 2007**

**Boston Stock Exchange**
*acquisition by*
Nasdaq
**$61,000,000**
**Pending***

**Syntonix**
*acquisition by*
Biogen Idec
**$120,000,000**
(including earnout)
**January 2007**

**Atlantic Bridge Ventures**
*acquisition of*
LogicaCMG's telecoms products business
**$525,000,000**
**June 2007**

**BAE Systems**
*sale of surveillance and attack business to*
Cobham Defence Electronic Systems
**$240,000,000**
**Pending***

**Parexel**
*acquisition of*
APEX International Clinical Research Co.
**$1,700,000,000**
(New Taiwan Dollars)
**September 2007**

**TechTarget**
*acquisition of*
KnowledgeStorm
**$58,000,000**
**November 2007**

**ETS**
*acquisition of Prometric from*
Thomson
**$435,000,000**
**October 2007**

**MapInfo**
*acquisition by*
Pitney Bowes
**$408,000,000**
**April 2007**

**Network Engines**
*acquisition of*
Alliance Systems
**$40,000,000**
**October 2007**

**Alantos Pharmaceuticals**
*acquisition by*
Amgen
**$300,000,000**
**July 2007**

**Irdeto**
*acquisition of*
Cloakware
**$72,500,000**
**November 2007**

**StatoilHydro**
*merger of Statoil with*
Norsk Hydro
**$30,000,000,000**
**October 2007**
(worldwide antitrust counsel)

**Mayne**
*acquisition by*
Hospira
**$2,000,000,000**
**February 2007**
(US antitrust counsel)

**Adnexus Therapeutics**
*acquisition by*
Bristol-Myers Squibb
**$430,000,000**
**October 2007**

* as of January 31, 2008

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Until recently, a businessperson might have been as likely to guess that "CFIUS" was a new strain of virus or a new intelligence agency as to identify it as an acronym for the Committee on Foreign Investment in the United States, a federal inter-agency committee charged with reviewing the national security implications of foreign investments in the United States. Beginning about five years ago, however, several controversial transactions, culminating with the Dubai Ports debacle in 2006, elevated CFIUS from relative obscurity to the front pages. And recent months have seen legislation and a presidential executive order bring some significant changes and further clarification to CFIUS.

These developments are pointed reminders that, although the United States prides itself on openness to foreign investments, such transactions may raise special regulatory and political issues. Parties to potential foreign acquisitions of US companies or assets need to consider CFIUS carefully in planning—and potentially in valuing—their transactions.

**Background**

Since Congress passed the Exon-Florio amendment in 1988, the President has been authorized to investigate the impact on US national security of "mergers, acquisitions, and takeovers" by foreign persons that result in foreign control over a US company or certain US assets. Exon-Florio applies both to proposed mergers and acquisitions and completed transactions. Unless a party to the transaction voluntarily seeks pre-closing review, there is no time limit on the President's authority to investigate a completed transaction. A voluntary notice that results in CFIUS clearance grants the transaction a safe harbor from post-closing review and challenge.

CFIUS is charged with implementing Exon-Florio. The Secretary of the Treasury chairs the Committee, but other agencies may take the lead for particular investigations, depending on the nature of the transaction.

The CFIUS notification process is voluntary, requires no filing fee, and imposes no mandatory pre-closing waiting period—although parties to a CFIUS review or investigation typically wait until the process is complete before closing. The process begins with an initial 30 day Committee review of the transaction, followed by an additional 45-day investigation if needed. After the 45-day investigation, the President has 15 days to permit or deny the acquisition (or to seek divesture after an ex post facto review).

The newly enacted Financial Investment and National Security Act (FINSA) gives CFIUS broad discretion to determine whether a 45-day investigation is needed, but it suggests two circumstances where an extended review is presumed more likely: when the transaction would result in "foreign government control" or foreign control of "critical infrastructure." The statute leaves the term "critical infrastructure" vague, but past experience suggests that telecommunications and transportation infrastructure would typically qualify, and the statute suggests that energy assets are also a form of critical infrastructure. The range of other assets that could fall within this definition, however, seems almost limitless.

**Scope and Focus of CFIUS Review**

In determining whether voluntarily to seek "safe harbor" protection by notifying CFIUS of a transaction, parties should assess the risk that CFIUS could investigate the transaction on its own initiative, and that—if the investigation were undertaken post-closing—it could potentially result in the unwinding of the transaction (or the imposition of terms and conditions that could affect the deal economics). In assessing these risks, parties should consider three threshold questions: Does the transaction involve a "foreign person" acquiring a "United States person"? Might the transaction implicate US national security interests? Might the structure of the transaction bring it outside CFIUS's jurisdiction altogether?

The first question can be surprisingly tricky and sometimes requires close analysis of the Exon-Florio statute and the CFIUS regulations. For instance, under Exon-Florio, the same entity or assets could be a "foreign person" or "United States person" depending on whether it is the target or the acquirer. Any entity is a "US person" to the extent of its business activities in the United States.

The second question is extraordinarily open-ended and may be susceptible to political considerations. FINSA gives some limited guidance, stating that national security includes "homeland security" concerns but not "economic security." FINSA also indicates that transactions involving "critical infrastructure," "critical technologies" and "major energy assets" may frequently raise national security concerns.

As a practical matter, the Committee has often shown particular interest in transactions when the target US company has export-controlled technologies, classified contracts with the US government or technologies critical to national defense, or when CFIUS member agencies have specific "derogatory intelligence" about the foreign purchaser. CFIUS may also examine whether the transaction will result in an absence of US-controlled companies that supply technology or products deemed important to US security. In April, the Treasury Department proposed new CFIUS regulations, which include some definitional and procedural changes but do not provide a limiting definition of "national security."

Two recent examples illustrate the broad range of transactions that may implicate national security for CFIUS purposes. Concerns about the CFIUS process played a substantial role in Chinese firm CNOOC's unsuccessful bid for US oil firm Unocal in 2005. The concerns were based largely on Unocal's crude reserves, which were located primarily outside the United States, in Southeast Asia, and on technology used in certain gasoline blends. Most recently, US government concerns about Huawei, a Chinese telecommunications equipment company, derailed a $2.2 billion bid by Bain Capital Partners and Huawei for

3Com, a provider of enterprise networking solutions. 3Com's intrusion detection software was considered a key, though not the exclusive, focus of concern.

The limits of CFIUS's jurisdiction have become increasingly important as foreign funds have stepped up the pace of investment in the United States. CFIUS lacks the authority to review transactions that do not "involve a change in control." Thus, acquisitions of voting securities that do not afford the acquirer de jure or de facto control do not trigger CFIUS. Moreover, acquisitions that are made solely for investment purposes are exempt if the acquirer will hold 10% or less of the outstanding voting securities. An "ordinary course" investment by a bank or investment company that does not typically acquire businesses may also fall outside CFIUS's purview.

Recent, significant foreign investments in US financial institutions by sovereign wealth funds and other investors have been structured to avoid CFIUS review using these guidelines. Typically, the investor has taken no board seats, obtained less than a 10 percent interest, and publicly disclaimed any ability to oversee or engage in the management of the company or business.

**The CFIUS Review Process and Strategic Considerations**

In determining whether voluntarily to notify CFIUS of a deal, the parties should:

- Construe the definition of national security broadly. Congress' newly enhanced oversight role may cause CFIUS to pay closer attention to concerns voiced by Capitol Hill about a proposed transaction.
- Scrutinize CFIUS factors particularly closely when the US target maintains sensitive, classified or export-controlled information and technologies, plays a role in "critical infrastructure," or has contracts with the intelligence community or government agencies like the Department of Defense and the Department of Homeland Security.
- Consider the nationality and the structure of the ownership and control of the foreign acquiring company. Connections to foreign governments—especially governments that are not US allies—are particularly critical factors in the analysis.

If a CFIUS notification may be appropriate, consider the costs and benefits of a voluntary CFIUS filing. The benefits of securing CFIUS clearance include:

- The ability to control the CFIUS "clock." If CFIUS decides independently to review a deal that was not voluntarily notified, the review calendar could begin at any time, potentially delaying the deal by as many as 90 days.
- A "safe harbor" from future Exon-Florio review and the possibility of post-closing unwinding, thereby eliminating a possible continuing cloud over the transaction following closing.
- The opportunity to address CFIUS issues affirmatively on the parties' own terms rather than being forced to start from a defensive posture after the Committee has initiated a review.
- Generating goodwill for the acquiring company within CFIUS, its member agencies and Congress by signaling sensitivity to US national security concerns.

On the other hand, the costs and burdens are not insignificant. They include:

- The expense and trouble of generating the required information and making the necessary submissions, as well as the delays inherent in the review process.
- The risk that notification itself might raise issues that would not otherwise have triggered scrutiny, although that risk will often be relatively small given the increased public and political focus on deals that may implicate national security concerns.
- Concessions CFIUS might require in return for approval of a transaction. In past transactions, these have included divesting subsidiaries with sensitive technology, "walling off" the foreign parent from control of the US entity and access to certain information, or entering into new agreements concerning network security or government access to critical infrastructure. (Concessions might be required anyway, however, if a CFIUS member agency initiates a CFIUS investigation.)

Another issue to consider is how competing bidders, business rivals or other stakeholders might use the CFIUS process to obtain leverage over the parties or to impact the timing and certainty of the transaction. If there are actual or potential alternative suitors who do not raise Exon-Florio issues, a foreign bidder may find itself paying a risk/time premium or agreeing to conditions such as break-up fees to compensate the target for the risk.

Finally, before making a filing, counsel should strongly consider informal consultation with the CFIUS staff about the transaction. Such discussions can influence the outcome and lead parties to modify their transaction before filing to expedite clearance, or avoid the possibility that the parties may have to abandon a transaction mid-review that is unlikely to be cleared at all, or only on unacceptable terms.

When to file is often almost as important a strategic consideration as whether to file. A key factor is the amount of scrutiny and controversy that the transaction is likely to generate among the CFIUS members, political leaders and the media. Parties sometimes delay their filing or withdraw and re-file to give CFIUS more time to examine a transaction.

**Conclusion**

CFIUS considerations may affect tactics for M&A activity that might raise national security issues. Targets need to take into account the additional time and risk that may be associated with national security reviews. Foreign acquiring companies may need to be more active in making commitments to address the risk of national security reviews, so as not to be at a disadvantage relative to domestic bidders. And in some cases parties may wish to structure their transactions to avoid CFIUS review altogether. In any event, parties need to plan in advance to navigate through these foreign investment filings and minimize the potential for surprises and a CFIUS challenge to the transaction. ■

Amendments to Rules 144 and 145 approved by the SEC in late 2007 should make the "private placement" alternative in M&A transactions more attractive to privately held target companies and their stockholders in stock-for-stock transactions with public company acquirers. Among other things, the amendments shorten the holding period under Rule 144 to six months, and remove the more burdensome restrictions on target company "affiliates" under Rule 144 and Rule 145.

These rule changes will offer target company stockholders the potential for earlier liquidity in deals structured as private placements and, as a result, give acquirers and targets greater structuring flexibility, with the potential for earlier—and more certain—closing.

When an acquirer issues stock to target company stockholders in an acquisition, the issuance either must be registered (typically on a Form S-4 registration statement) or made pursuant to an exemption from the registration requirements of the Securities Act of 1933. Stock issued in a private placement under the safe harbor of Regulation D, or pursuant to another exemption from registration, is restricted stock and may only be resold in the market pursuant to Rule 144 if the following requirements are met:

- the shares have been held for the minimum holding period specified in the rule;
- the issuer satisfies the current public information requirements;
- sales do not exceed the maximum amount stipulated in the rule;
- sales are made in the prescribed manner; and
- a notice is filed with the SEC unless the amount sold is below the filing threshold.

Stock registered on Form S-4 may be resold immediately, offering target stockholders significantly earlier liquidity. Resale registration rights can shrink or even eliminate the "liquidity gap" (especially if the acquirer is a well-known seasoned issuer, or "WKSI"), but resale registration undertakings often impose disclosure burdens on acquirers and are subject to "blackout" periods and other limitations that limit sellers' liquidity.

Effective February 15, 2008, amendments to Rules 144 and 145 reduced the holding period for restricted stock from one year to six months and eliminated some of the restrictions that had previously applied to target stockholders who were "affiliates" of the target but not of the acquirer. As a result, these amendments will significantly shrink the "liquidity gap" and narrow the difference in timelines between signing of the definitive acquisition agreement and first liquidity—the time when target stockholders are able to begin selling the shares they receive in the transaction.

A typical timeline from signing to closing in a stock-for-stock or mixed cash-stock acquisition involving a Form S-4 registration statement is 90 to 120 days, or more. In contrast, a private placement may allow a simultaneous sign-and-close (at least where there are no post-signing/pre-closing regulatory approvals, waiting periods or third-party consents). As a result, the new six month holding period under Rule 144 should reduce the effective liquidity advantage of an S-4 to between 60 and 90 days—or about one calendar quarter. This stands in contrast to an expected "liquidity gap" of about nine months (or more) under the holding period previously required by Rule 144. As a practical matter, target companies and selling stockholders are likely to have more visibility into the near-term business and market outlook than the longer-term outlook, and are more likely to accept a one-calendar-quarter delay in liquidity than a three-calendar-quarter delay.

Faster and more certain closing may be attractive to buyers and targets for additional reasons. In a registered deal, the transaction cannot close (and generally stockholders cannot even vote) until the Form S-4 is declared effective by the SEC. In times of heightened business uncertainty (including the possibility of interlopers), as well as market uncertainty and volatility, the ability to close quickly can reduce the risks resulting from stock price, business and macroeconomic volatility—and can mean the difference between a completed deal and a broken deal, a deal at a different price or no deal at all.

In addition to shortening the holding period under Rule 144, the SEC concurrently approved changes to Rule 145 that eliminate most of the restrictions that have, until now, applied to stockholders who are "affiliates" of the target company (but not of the acquirer). Under the amended rules, "target-only" affiliates are no longer subject to the more onerous affiliate provisions of Rule 144 that remain (relating to volume and manner of sale and filing requirements) on the resale of securities received in the deal. This has the added benefit in registered deals of eliminating entirely all restrictions on resale by "target-only" affiliates.

Some limitations under the amended rules are worth noting. The shorter holding period will not apply to stock issued by acquirers that are "shell" companies under SEC rules, voluntary filers (companies that voluntarily file periodic reports with the SEC), or acquirers that are not current in their public company reporting obligations at the relevant time. In addition, the private placement structure will not be available in every private company acquisition. For example, target companies with a large number of "non-accredited" stockholders will not qualify.

Careful analysis is required to determine if a transaction can be structured as a valid private placement, and whether risks exist (such as a large overhang of exercisable stock options) that may jeopardize a transaction's status as a valid private placement. But where a private placement is possible, the new amendments to Rules 144 and 145 should make it advantageous for all parties to consider private placement structures for M&A transactions. ■

In December 2007, the Financial Accounting Standards Board (FASB) adopted a new accounting standard governing M&A transactions. For calendar-year companies, the new standard will apply to all acquisitions, beginning January 1, 2009. Companies and their deal lawyers will need to become familiar with these new standards, as they will likely have a substantial impact on transaction planning.

Under the current standard, called Statement of Financial Accounting Standards 141 (SFAS 141), all acquisition transactions are accounted for using the "purchase method." The total consideration paid in an acquisition is determined and then allocated to identifiable assets acquired and liabilities assumed, in each case at their value as of the date of closing. Any excess of the purchase price over the value of the assets and liabilities is recorded as goodwill.

Revised Statement of Financial Accounting Standards 141 (SFAS 141R) modifies the conceptual framework for accounting for business combination transactions. The purchase method uses a "cost-allocation" approach, in which the total cost of an acquisition is determined and then allocated to the specific assets and liabilities acquired. Acquisition accounting under SFAS 141R adopts a "fair value" approach. The principal inquiry is to determine the value of the assets and liabilities to the business as of the date of the acquisition and to record those values.

The clearest example of the impact of this change is in the treatment of acquisition expenses, such as investment banking and legal fees. Under prior SFAS 141, these costs are capitalized and allocated to the assets and liabilities acquired. Under the new rules, these transaction costs are recorded as an expense as of the acquisition date.

Other significant changes to M&A accounting under the new standard include:

- *Earnouts:* The fair value of contingent consideration must be determined and recorded as of the acquisition date. Changes in fair value resulting from changes in the likelihood or amount of contingent payments can result in charges to P&L in future periods. Previously, contingent consideration payments were recorded only when they became payable.
- *Contingencies:* "Contractual" contingencies, such as future warranty claims, that are assumed in the acquisition must be recognized at fair value as of closing. The fair value of these contingencies will be "marked-to-market" quarterly and changes in fair value charged to P&L. "Non-contractual" contingencies such as litigation must be recorded at fair value at closing if the possibility of an adverse outcome is "more likely than not." Complicated rules govern whether and how changes in fair value of non-contractual contingents are accounted for in subsequent periods. Previously, a contingency acquired in an acquisition was recorded only if a loss was probable and the amount of the loss was reasonably estimable.
- *Valuation of Consideration:* The value of stock consideration will be measured as of the closing date. As a result, changes in the value of stock between signing and closing will affect the amount of goodwill recorded in the transaction. This goodwill will then have to be considered for impairment and potentially written down in future periods. Previously, the value of stock consideration was measured as of the agreement date.
- *In-process R&D:* The fair value of in-process research and development will have to be recognized as of the closing date and amortized. This may result in ongoing P&L charges. Previously, in-process R&D could be written off as of closing.
- *Measurement Period:* Acquirers will have up to one year in which to complete accounting for the business combination. If provisional information that is initially recorded is subsequently changed, however, the acquirer will have to recognize these adjustments as of the acquisition date, revise the comparative information for prior periods and provide disclosures about the changes to provisional numbers. Previously, acquirers had a one-year period to complete the accounting, but they did not need to retrospectively adjust previously reported numbers.
- *Equity-based Incentives:* If an acquirer issues vested options to holders of the acquiree's unvested options, a portion of the fair value of the new options will be considered compensation expense and recorded in post-closing periods. Previously, the acquirer could include the full value of the new options in the purchase price and not record any compensation expense.
- *Step Transactions:* If an acquirer acquires control by more than one transaction over time, the transaction that results in acquisition of control triggers a revaluation of all assets and liabilities of the acquired entity, as well as of any non-controlling interest. Any difference between the fair value at the time of the control acquisition and the previous fair value will be recorded in P&L. Previously, each purchase was accounted for as a separate transaction and no revaluation was required.

The new standard also prescribes special rules in other areas, including employee benefit obligations, pre-existing relationships between the acquirer and acquiree and/or selling stockholders, "bargain purchases," and income taxes. In addition, the new standard prescribes expanded disclosure for business combination transactions.

The new standard is likely to have significant implications. Among other things, the standard will present difficult valuation issues. It may also contribute to earnings volatility because of possible P&L charges in current and future periods. The requirement for revision of previously reported financial statements based on determinations of values post-closing may lead to more diligence pre-closing to minimize the need for such adjustments.

These and other considerations may affect deal structuring. For example, earnouts may become impracticable due to the potential P&L impact of future changes in the valuation of the earnout. Similarly, the terms of stock consideration may have to be structured differently to take account of the uncertainty created by measuring the value of the stock as of closing rather than signing. ■

We reviewed all merger transactions between 2004 and 2007 involving venture-backed targets (as reported in Dow Jones VentureOne) where 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 | | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| The number of deals we reviewed and the type of consideration paid in each | Sample Size | 54 | 39 | 53 | 33 |
| | Cash | 43% | 69% | 68% | 48% |
| | Stock | 41% | 10% | 8% | 0% |
| | Cash and Stock | 17% | 21% | 24% | 52% |
| **Deals with Earn-Out** | | **2004** | **2005** | **2006** | **2007** |
| Deals that provided contingent consideration based upon post-closing performance of the target (other than balance sheet adjustments) | With Earn-Out | 24% | 15% | 17% | 39% |
| | Without Earn-Out | 76% | 85% | 83% | 61% |
| **Deals with Indemnification** | | **2004** | **2005** | **2006** | **2007** |
| 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 | 89% | 100% | 94% | 100% |
| | By Buyer[1] | 37% | 46% | 38% | 48% |
| **Survival of Representations and Warranties** | | **2004** | **2005** | **2006** | **2007** |
| Length of time that representations and warranties survived the closing for indemnification purposes[2] | Shortest | 6 Months | 9 Months | 12 Months | 6 Months[3] |
| | Longest | 36 Months | 24 Months | 36 Months | 36 Months |
| | Most Frequent | 12 Months | 12 Months | 12 Months | 12 and 18 Months (tie) |
| **Caps on Indemnification Obligations** | | **2004** | **2005** | **2006** | **2007** |
| Upper limits on indemnification obligations where representations and warranties survived the closing for indemnification purposes | With Cap | 85% | 100% | 100% | 97% |
| | Limited to Escrow | 72% | 79% | 84% | 78% |
| | Limited to Purchase Price | 7% | 5% | 2% | 9% |
| | Exceptions to Limits[4] | 74% | 73% | 84% | 97% |
| | Without Cap | 15% | 0% | 0% | 3% |

[1] The buyer provided indemnification in 48% of the 2004 transactions, 25% of the 2005 transactions, 41% of the 2006 transactions and 53% of the 2007 transactions where buyer stock was used as consideration. In 65% of the 2004 transactions, 17% of the 2005 transactions, 35% of the 2006 transactions and 56% of the 2007 transactions where the buyer provided indemnification, buyer stock was used as consideration.

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

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

[4] Generally, exceptions were for fraud and willful misrepresentation.

| Escrows | | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Deals having escrows securing indemnification obligations of the target's shareholders | **With Escrow** | 83% | 97% | 96% | 94% |
| | % of Deal Value | | | | |
| | Lowest | 4% | 2% | 3% | 3% |
| | Highest | 23% | 20% | 20% | 43% |
| | Most Frequent | 10%–20% | 10% | 10% | 10% |
| | Length of Time | | | | |
| | Shortest | 6 Months | 6 Months | 12 Months | 6 Months |
| | Longest | 36 Months | 24 Months | 36 Months | 60 Months |
| | Most Frequent | 12 Months | 12 Months | 12 Months | 12 and 18 Months (tie) |
| | Exclusive Remedy | 64% | 84% | 90% | 73% |
| | Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy[5] | 72% | 66% | 86% | 100% |

| Baskets for Indemnification | | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Deals with indemnification where a specified "first dollar" amount did not count towards indemnification, expressed either as a "deductible" (where such amount can never be recovered) or as a "threshold" (where such dollar amount cannot be recovered below the threshold but once the threshold is met all such amounts may be recovered) | **Deductible** | 39% | 38% | 48% | 48%[6] |
| | **Threshold** | 51% | 62% | 52% | 39%[6] |

| MAE Closing Condition | | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Deals where the buyer or the target had as a condition to its obligation to close the absence of a "material adverse effect" with respect to the other party or its business, either in condition explicitly or through representation brought down to closing | **Condition in Favor of Buyer** | 81% | 82% | 98% | 97% |
| | **Condition in Favor of Target**[7] | 30% | 13% | 23% | 44% |

| Exceptions to MAE | | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Deals where definition of "material adverse effect" for the target contained specified exceptions | **With Exception**[8] | 78% | 79% | 85% | 91% |

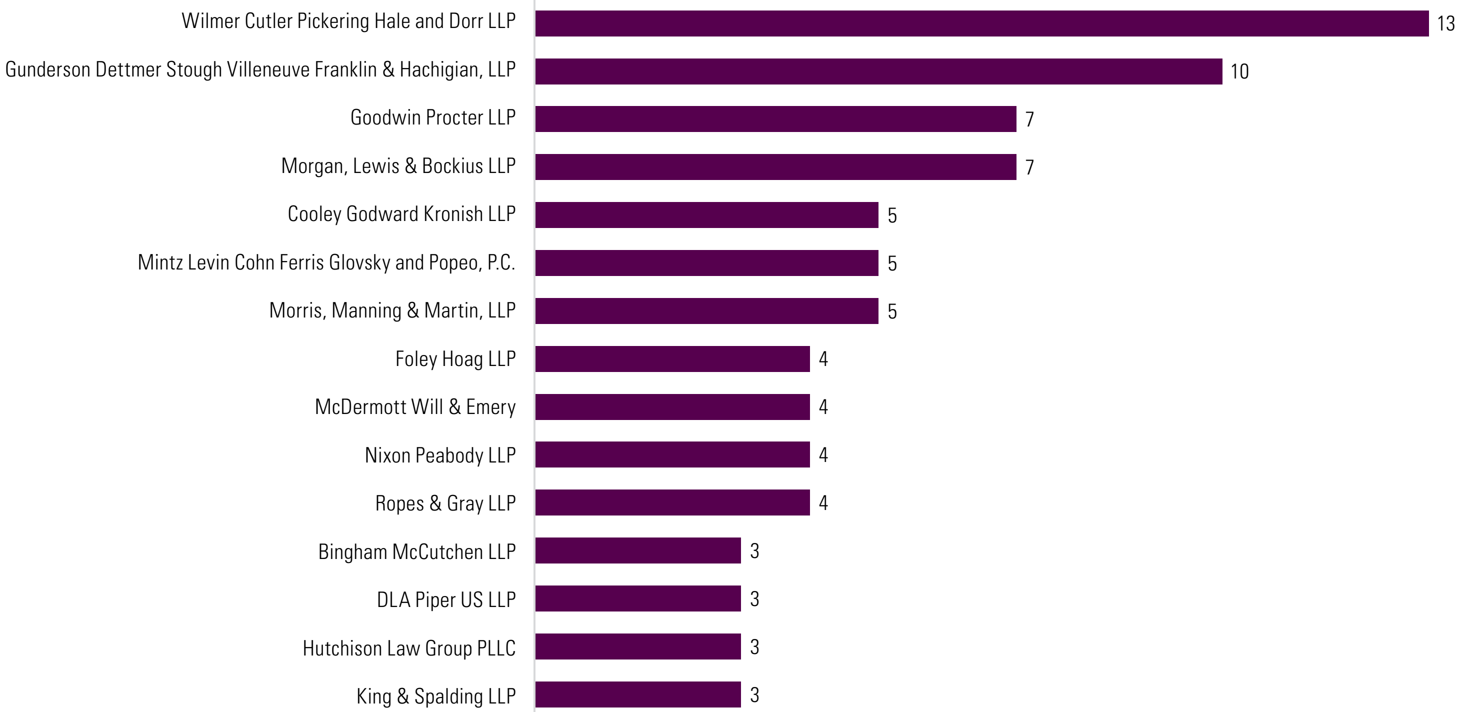
[5] Generally, exceptions were for fraud, intentional misrepresentation and criminal activity.

[6] Another 13% of these transactions used a "hybrid" approach with both a deductible and a threshold.

[7] In 50% of these transactions in 2004, in 80% of these transactions in 2005, in 83% of these transactions in 2006 and in 86% of these transactions in 2007, buyer stock was used as consideration.

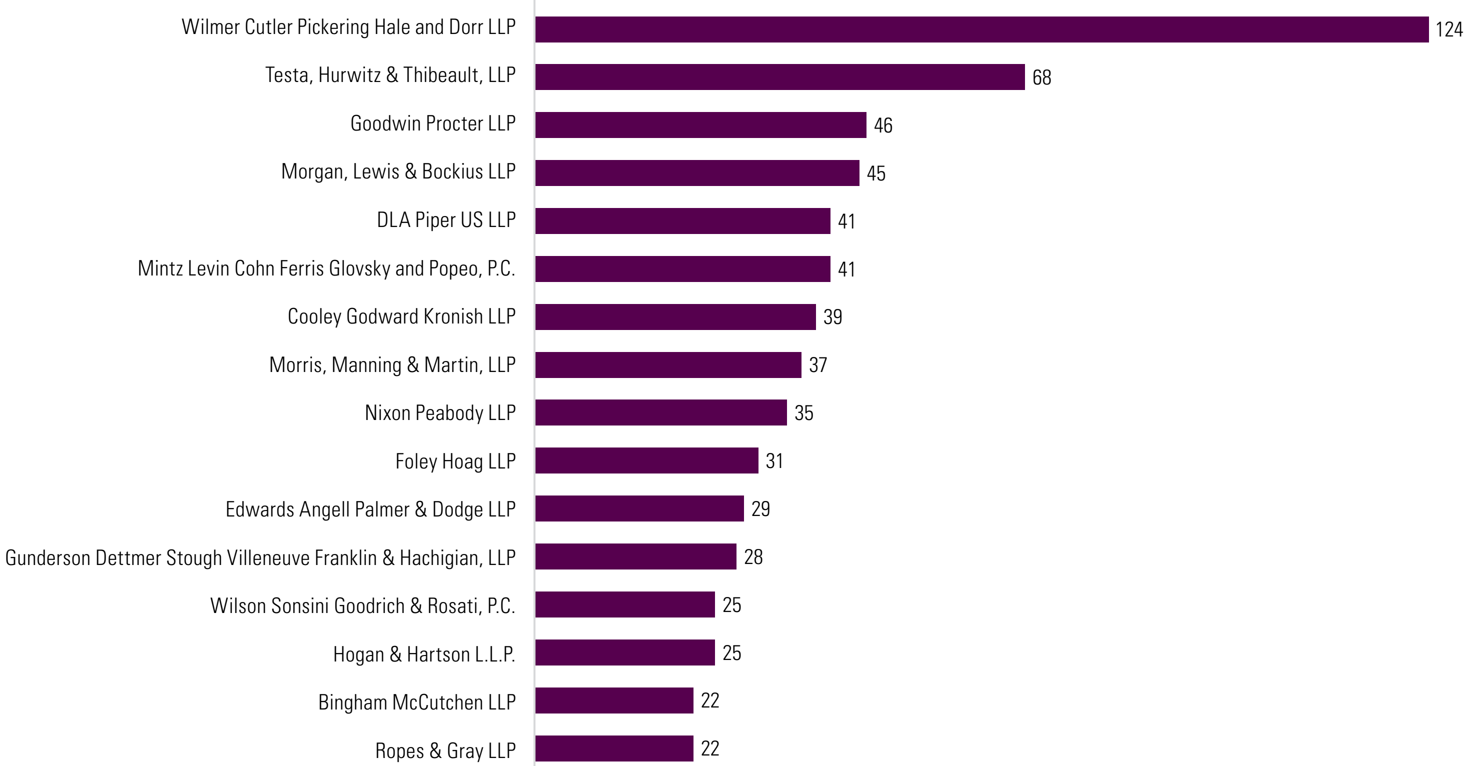
[8] Generally, exceptions were for general economic and industry conditions.

## Company Counsel in Sales of Eastern US VC-Backed Companies in 2007




*Source: Dow Jones VentureOne*

## Company Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2007




*Source: Dow Jones VentureOne*

*The above charts are based on companies located east of the Mississippi River.*

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### Data Sources

M&A data is sourced from MergerStat. Data for sales of VC-backed companies is sourced from Dow Jones VentureOne. Private equity–backed M&A data is sourced from Thomson Reuters. For law firm rankings, sales of VC-backed companies are included under the current name of each law firm.

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