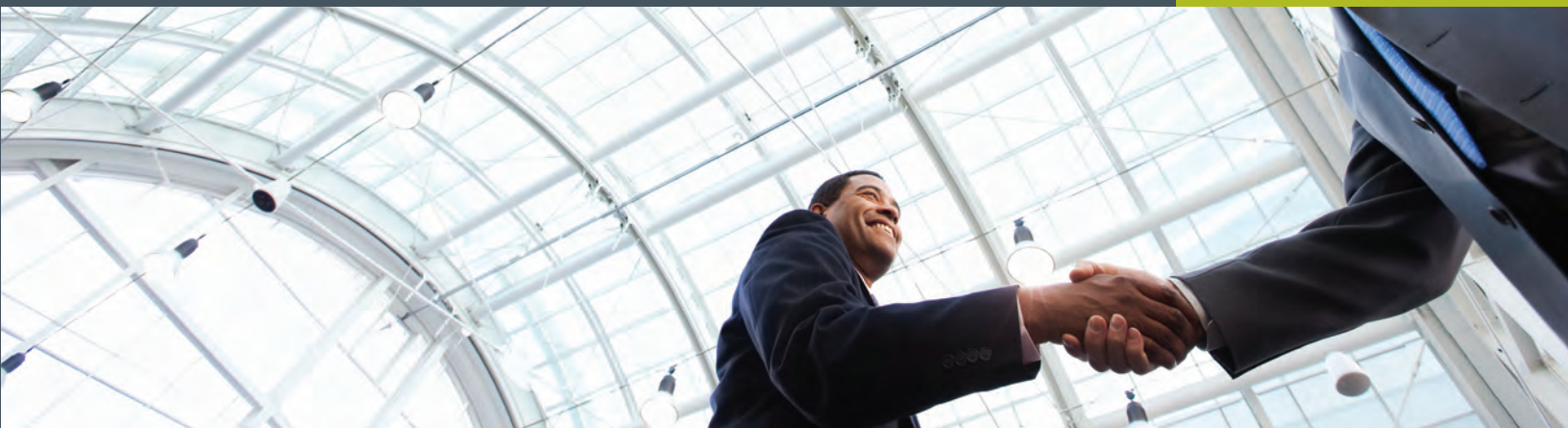


# 2015 M&A Report

CORPORATE



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## 2015 M&A Report – Table of Contents

|           |   |
|-----------|---|
| <b>2</b>  | Market Review and Outlook   |
| <b>4</b>  | Takeover Defenses: An Update  |
| <b>7</b>  | Proxy Access: The Plot Thickens   |
| <b>8</b>  | The Use of Social Media in Contested Situations                                 |
| <b>9</b>  | Law Firm Rankings   |
| <b>10</b> | Selected WilmerHale M&A Transactions  |
| <b>12</b> | Merger Control Trends Every Dealmaker Needs to Know                             |
| <b>13</b> | Lessons from <i>Cigna v. Audax</i> : How to Protect the Benefit of Your Bargain |
| <b>14</b> | Pre-IPO Acquisition Challenges  |
| <b>15</b> | A Comparison of Deal Terms in Public and Private Acquisitions                   |
| <b>18</b> | Trends in VC-Backed Company M&A Deal Terms                                      |
| <b>20</b> | <i>Initial Public Offerings: A Practical Guide to Going Public</i>              |

## 2 Market Review and Outlook

### REVIEW

Fueled by improvements in macroeconomic conditions, high levels of cash among strategic acquirers and low interest rates, the M&A market produced record or near-record results across most geographies and sectors in 2014.

Global M&A deal volume rebounded in 2014, after two consecutive years of contraction. The total number of reported M&A transactions worldwide increased 17%, from 26,939 in 2013 to 31,427 in 2014—just shy of the number of deals in 2007, when the market reached its post-2000 peak. Global M&A deal value surged 57%, from \$1.87 trillion to \$2.94 trillion—the highest level since at least 2000.

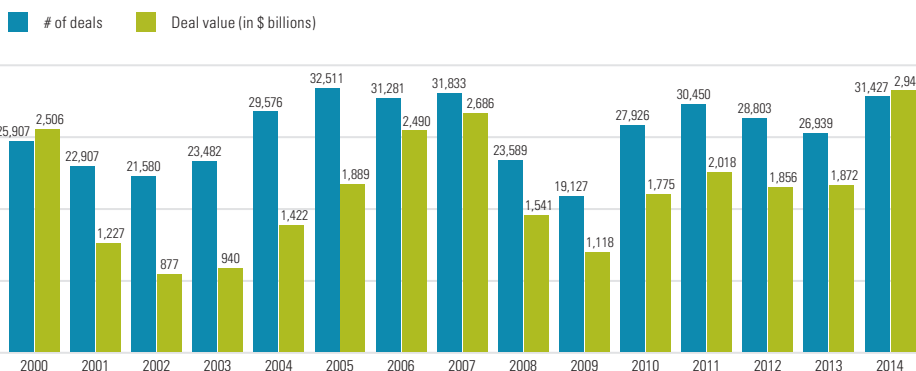
The number of worldwide billion-dollar transactions increased 39%, from 343 in 2013 to 477 in 2014. Aggregate global billion-dollar deal value grew 74%, from \$1.12 trillion to \$1.95 trillion.

#### Geographic Results

Reversing the declines of recent years, deal volume and total deal value increased across all geographic regions in 2014, producing post-2000 record levels of transaction proceeds and average deal sizes:

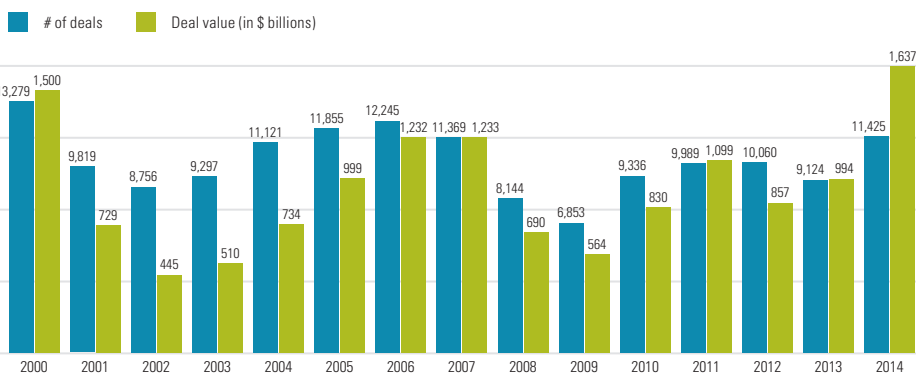
- **United States:** Deal volume increased 25%, from 9,124 transactions in 2013 to 11,425 in 2014. US deal value jumped 65%, from \$994.0 billion to \$1.64 trillion, resulting in a 32% increase in average deal size from \$108.9 million to \$143.3 million—the highest total deal value and average deal size in the United States since at least 2000. The number of billion-dollar transactions involving US companies increased by 47%, from 204 in 2013 to 300 in 2014, while the total value of these transactions grew 78%, from \$748.5 billion to \$1.33 trillion.
- **Europe:** Deal flow in Europe improved in 2014 after two consecutive years of decline, and total deal value nearly doubled. The number of transactions increased 15%, from 11,222 in 2013 to 12,893 in 2014, while total deal value leapt from \$625.3 billion to \$1.17 trillion, resulting in a 62% increase in average deal size from \$55.7 million to \$90.5 million—the highest total deal value and average deal size in Europe since 2007. The number of billion-dollar transactions

### Global M&A Activity – 2000 to 2014



Source: FactSet Mergers

### US M&A Activity – 2000 to 2014



Source: FactSet Mergers

involving European companies increased 39%, from 158 in 2013 to 220 in 2014, while their total value grew 67%, from \$530.7 billion to \$888.2 billion.

- **Asia-Pacific:** The Asia-Pacific region saw deal volume increase 13%, from 8,177 transactions in 2013 to 9,252 in 2014. Total deal value in the region grew 54%, from \$448.4 billion to \$688.5 billion, resulting in a 36% increase in average deal size from \$54.8 million to \$74.4 million—the highest total deal value and average deal size in the region since at least 2000. Billion-dollar transactions involving Asia-Pacific companies increased 33%, from 84 in 2013 to 112 in 2014, while their total value grew 72%, from \$192.7 billion to \$331.6 billion.

#### Sector Results

M&A activity increased across principal industry sectors in 2014, with strong increases in technology and life sciences

and more moderate increases in the financial services and telecommunications sectors. Of particular note, total deal value soared in the life sciences sector, increased substantially in the technology sector, and remained at the second-highest level since 2000 in the telecommunications sector.

- **Technology:** Global transaction volume in the technology sector increased 22%, from 3,877 deals in 2013 to 4,720 deals in 2014, while global technology deal value increased 46%, from \$143.4 billion to \$209.8 billion. US technology deal volume increased 26%, from 1,917 in 2013 to 2,407 in 2014, and US technology total deal value enjoyed a 48% increase, from \$105.5 billion to \$156.1 billion. The year's results represent the highest transaction volume and deal value in the technology sector globally and in the United States since 2000.

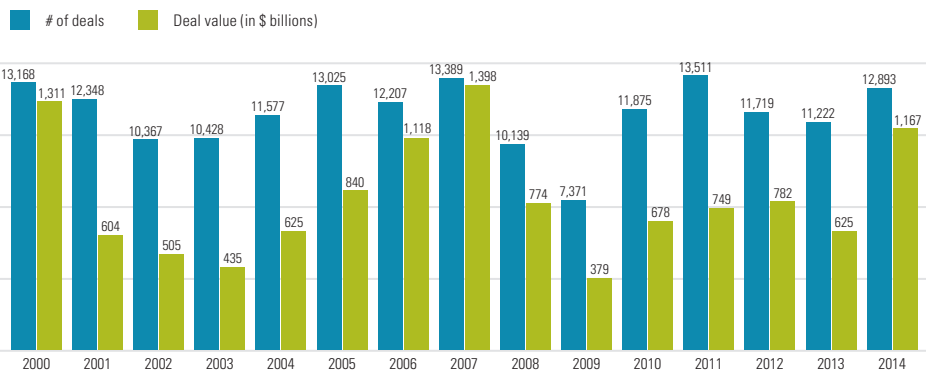
- **Life Sciences:** Mirroring its performance in the IPO market, the life sciences sector reached new M&A levels in 2014. Global transaction volume in the sector increased 19%, from 1,096 deals in 2013 to 1,306 deals in 2014, while global deal value increased nearly three-fold, from \$134.9 billion to \$379.4 billion. In the United States, which dominates M&A activity in the life sciences sector, deal volume increased 37%, from 404 in 2013 to 553 in 2014, while total deal value more than tripled, from \$100.0 billion to \$304.2 billion. The year's results represent the highest transaction volume and deal value in the life sciences sector globally and in the United States since at least 2000.

- **Financial Services:** After declining for two consecutive years, global M&A activity in the financial services sector rebounded in 2014. Global transaction volume in the sector increased 12%, from 1,257 deals in 2013 to 1,409 deals in 2014, while global deal value increased 8%, from \$143.5 billion to \$154.8 billion. In the United States, financial services sector deal volume increased 10%, from 430 in 2013 to 473 in 2014, while total deal value decreased 17%, from \$59.3 billion to \$49.2 billion.

- **Telecommunications:** Global transaction volume in the telecommunications sector inched up from 792 deals in 2013 to 800 deals in 2014. After more than doubling from 2012 to 2013 as a result of one of the largest M&A transactions of all time (Verizon's 2013 buyout of Vodafone's 45% stake in Verizon Wireless for \$124.1 billion), global telecommunications deal value in 2014 held steady, with a \$243.3 billion tally that essentially matched 2013 for the highest deal value in the global telecommunications sector since 2000. US telecommunications deal volume increased slightly, from 250 in 2013 to 258 in 2014, but total deal value dropped 31%, from \$153.5 billion to \$105.9 billion, as no transaction approaching the size of the prior year's Vodafone–Verizon Wireless deal occurred in 2014.

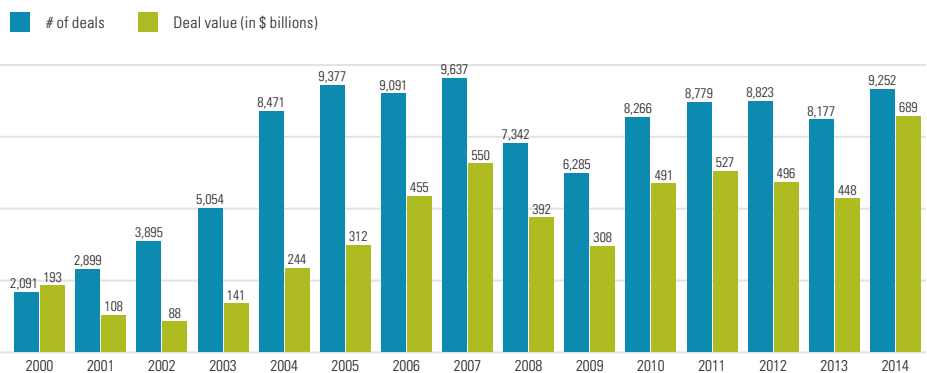
- **VC-Backed Companies:** Reversing a three-year decline, the M&A market for venture-backed companies expanded in 2014. The number of reported acquisitions of VC-backed companies increased 8%, from 449 in 2013 to 483 in 2014, while

### European M&A Activity – 2000 to 2014



Source: FactSet Mergers

### Asia-Pacific M&A Activity – 2000 to 2014



Source: FactSet Mergers

total proceeds nearly doubled, increasing from \$41.3 billion to \$79.8 billion.

### OUTLOOK

M&A activity in 2015 will depend on a number of factors, including the following:

- **Economic Conditions:** While there are lingering concerns about the extent of the global economic recovery, the US Federal Reserve's decision to keep interest rates close to zero substantially lowers the cost of large takeovers funded by debt. For companies facing limited growth opportunities, acquisitions are a natural avenue to bolster market share, build out brands and pursue longer-term strategic initiatives.
- **Private Equity Impact:** On the sell side, private equity firms continue to dispose of companies acquired during the pre-crisis buyout boom as debt

obligations become due. On the buy side, "dry powder" (unspent capital that investors have committed to provide for investing over a period of time) remains at near-record levels. The result is likely to be a continuation of the ferocious competition for attractive deals and rising valuations experienced in 2014.

- **Venture Capital Pipeline:** The venture capital pipeline is brimming with acquisition targets, and many venture-backed companies and their investors prefer the relative ease and certainty of being acquired to the lengthier and more uncertain IPO process. For established companies grappling with the emergence of disruptive innovations, technology companies will remain attractive targets.

Economic challenges remain, but the above factors encourage favorable expectations for the M&A market over the coming year. ■

## 4 Takeover Defenses: An Update

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

### CLASSIFIED BOARDS

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

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

### SUPERMAJORITY VOTING REQUIREMENTS

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

Advocates for supermajority vote requirements claim that these provisions help preserve and maximize the value of the company for all stockholders by ensuring that important corporate actions are taken only when it is the clear will of the stockholders. Opponents, however, believe that majority-vote requirements make the company more accountable to stockholders by making it easier for stockholders to make changes in how the company is governed. Supermajority requirements are also viewed by their detractors as entrenchment provisions used to block initiatives that are supported by holders of a majority of the company’s

stock but opposed by management and the board. In addition, opponents believe that supermajority requirements—which generally require votes of 60% to 80% of the total number of outstanding shares—can be almost impossible to satisfy because of abstentions, broker non-votes and voter apathy, thereby frustrating the will of stockholders.

### PROHIBITION OF STOCKHOLDERS’ RIGHT TO ACT BY WRITTEN CONSENT

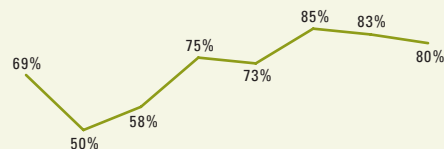
*Should stockholders have the right to act by written consent without holding a stockholders’ meeting?*

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

### Trends in Takeover Defenses Among IPO Companies

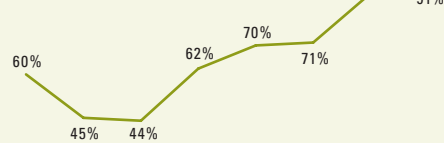
2007 2008 2009 2010 2011 2012 2013 2014

Overall: 76%



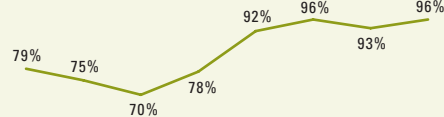
Classified board

Overall: 73%



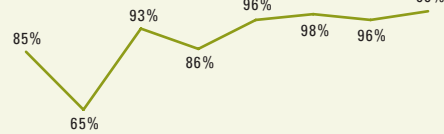
Supermajority voting requirements to approve mergers or change corporate charter and bylaws

Overall: 88%



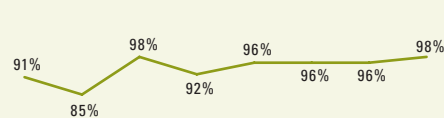
Prohibition of stockholders’ right to act by written consent

Overall: 93%



Limitation of stockholders’ right to call special meetings

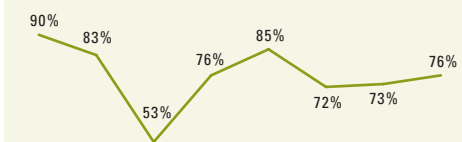
Overall: 95%



Advance notice requirements

2007 2008 2009 2010 2011 2012 2013 2014

Overall: 77%



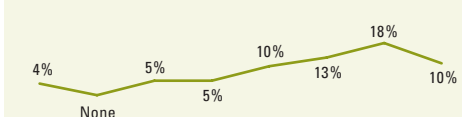
Section 203 of the Delaware corporation statute (not opt out)\*

Overall: 96%



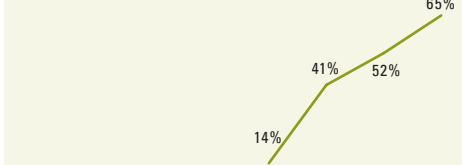
Blank check preferred stock

Overall: 10%



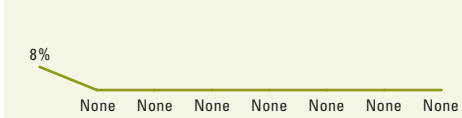
Multi-class capital structure

Overall: 49%



Exclusive forum provisions\*

Overall: 1%



Stockholder rights plan

\*Delaware corporations only

Source: WilmerHale analysis of SEC filings from 2007 to 2014 (2011–2014 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

## Prevalence of Takeover Defenses Among IPO Companies and Established Public Companies

|   | IPO COMPANIES | ESTABLISHED PUBLIC COMPANIES<br>S&P 500       | RUSSELL 3000                                  |
|---|---------------|---|---|
| Classified board  | 76%           | 10%   | 43%   |
| Supermajority voting requirements to approve mergers or change corporate charter and bylaws | 73%           | 21% to 43%,<br>depending on type<br>of action | 18% to 57%,<br>depending on type<br>of action |
| Prohibition of stockholders' right to act by written consent                                | 88%           | 70%   | 72%   |
| Limitation of stockholders' right to call special meetings                                  | 93%           | 41%   | 51%   |
| Advance notice provisions   | 95%           | 95%   | 90%   |
| Section 203 of the Delaware corporation statute (not opt out)*                              | 77%           | 95%   | 84%   |
| Blank check preferred stock   | 96%           | 95%   | 95%   |
| Multi-class capital structure   | 10%           | 9%  | 11%   |
| Exclusive forum provisions*   | 49%           | 20%   | 24%   |
| Stockholder rights plan   | 1%            | 6%  | 9%  |

\*Delaware corporations only

Source: IPO company data is based on WilmerHale analysis of SEC filings from 2007 to 2014 (2011–2014 only for exclusive forum provisions) for US issuers. Established public company data is from SharkRepellent.net at year-end 2014.

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 reasonable control premium, but could prevent stockholders from accepting an attractive acquisition offer that is opposed by an entrenched board.

### BLANK CHECK PREFERRED STOCK

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

When blank check preferred stock is authorized, the board has the right to issue

## 6 Takeover Defenses: An Update

### Prevalence of Takeover Defenses Among Types of IPO Companies

|   | ALL IPO COMPANIES | VC-BACKED COMPANIES | PE-BACKED COMPANIES | OTHER IPO COMPANIES |
|---|-------------------|---------------------|---------------------|---------------------|
| Classified board  | 76%               | 87%                 | 76%                 | 49%                 |
| Supermajority voting requirements to approve mergers or change corporate charter and bylaws | 73%               | 82%                 | 76%                 | 50%                 |
| Prohibition of stockholders' right to act by written consent                                | 88%               | 93%                 | 89%                 | 71%                 |
| Limitation of stockholders' right to call special meetings                                  | 93%               | 96%                 | 96%                 | 81%                 |
| Advance notice provisions   | 95%               | 97%                 | 97%                 | 87%                 |
| Section 203 of the Delaware corporation statute (not opt out)*                              | 77%               | 97%                 | 42%                 | 73%                 |
| Blank check preferred stock   | 96%               | 97%                 | 99%                 | 89%                 |
| Multi-class capital structure   | 10%               | 6%                  | 11%                 | 16%                 |
| Exclusive forum provisions*   | 49%               | 45%                 | 62%                 | 42%                 |
| Stockholder rights plan   | 1%                | 2%                  | 0.5%                | 1%                  |

\*Delaware corporations only

Source: WilmerHale analysis of SEC filings from 2007 to 2014 (2011–2014 only for exclusive forum provisions) for US issuers.

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

### MULTI-CLASS CAPITAL STRUCTURES

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

While most companies go public with a single class of common stock that provides the same voting and economic rights to

every stockholder (a “one share, one vote” model), some companies go public with a multi-class capital structure under which specified pre-IPO stockholders (typically founders) hold shares of common stock that are entitled to multiple votes per share, while the public is issued a separate class of common stock that is entitled to only one vote per share. Use of a multi-class capital structure facilitates the ability of the holders of the high-vote class of common stock to retain voting control over the company and to pursue strategies to maximize long-term stockholder value. Critics believe that a multi-class capital structure entrenches the holders of the high-vote stock, insulating them from takeover attempts and the will of public stockholders, and that the mismatch between voting power and economic interest may also increase the possibility that the holders of the high-vote stock will pursue a riskier business strategy.

### EXCLUSIVE FORUM PROVISIONS

*Should the company stipulate in its corporate charter or bylaws that the Court of Chancery of the State of Delaware is*

*the exclusive forum in which it and its directors may be sued by stockholders?*

Following a March 2010 decision by the Delaware Court of Chancery, numerous Delaware corporations have included provisions in their corporate charter or bylaws to the effect that the Court of Chancery of the State of Delaware is the exclusive forum in which state-law stockholder claims may be brought against the company and its directors. Proponents of exclusive forum provisions are motivated by a desire to adjudicate stockholder claims in a single jurisdiction that has a well-developed and predictable body of corporate case law and an experienced judiciary. Opponents argue that these provisions deny aggrieved stockholders the ability to bring litigation in a court or jurisdiction of their choosing.

### STOCKHOLDER RIGHTS PLANS

*Should the company establish a poison pill?*

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

## BACKGROUND

The SEC's proxy rules permit stockholders to submit proposals for inclusion in a company's proxy statement. In the case of board elections, and subject to any procedural requirements imposed by the company's bylaws, the proxy rules also permit stockholders to propose an alternative slate of director nominees. Historically, dissident stockholders have not been permitted to include alternative director nominations in the company's proxy statement—dubbed “proxy access”—and instead have been required to incur the expense and effort of preparing, filing, printing and distributing a competing proxy statement.

## PROXY ACCESS RULE

On several occasions prior to 2010, the SEC proposed—but did not adopt—proposals that would have granted proxy access. In August 2010, acting on express authority contained in the Dodd-Frank Act, the SEC approved a proxy access rule (Rule 14a-11) requiring public companies to include in their proxy materials the names of director nominees submitted by stockholders who, individually or in the aggregate with other stockholders acting together:

- own at least 3% of the company's voting stock;
- have held those shares continuously for at least three years;
- nominate persons who satisfy the objective independence standards of the stock exchange on which the company's shares are listed; and
- do not have the intent of changing control of the company or gaining more seats on the board than the maximum number allowed by the rule.

Rule 14a-11 limited the number of board members at any one time who were nominated by stockholders in this manner to the greater of one director or 25% of the entire board of directors. Concurrently with its adoption of this proxy access rule, the SEC amended Rule 14a-8 to permit stockholders to submit proposals seeking greater proxy access than provided by Rule 14a-11.

In July 2011, the US Court of Appeals for the DC Circuit struck down Rule

14a-11. The amendment to Rule 14a-8 permitting stockholders to submit proxy access proposals was not challenged in the litigation and thereafter went into effect.

## RECENT SURGE IN SHAREHOLDER PROPOSALS

In the absence of an SEC rule on proxy access, the battleground has shifted to proxy access shareholder proposals under Rule 14a-8. An unprecedented number of shareholder proposals on proxy access have already been submitted for the 2015 proxy season, and more are anticipated based on public statements by institutional investors. The surge in proxy access shareholder proposals has been followed by an increased focus on the ability of companies to exclude such proposals from their proxy statements.

Rule 14a-8(i)(9) permits a company to exclude from its proxy statement a shareholder proposal that directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting. As historically interpreted, a shareholder and management proposal need not be identical in scope or focus for the exclusion to be available. Rather, the SEC staff has permitted companies to exclude any shareholder proposal if the inclusion of the management proposal and the shareholder proposal in the same proxy statement could “present alternative and conflicting decisions for shareholders” or if “submitting both proposals to a vote could provide inconsistent and ambiguous results”—even where a shareholder proposal and a management proposal take completely opposing approaches to a topic.

While companies are not required to obtain no-action relief from the staff to exclude shareholder proposals under Rule 14a-8—the rule requires only that a company that plans to exclude a proposal file its reasons for excluding the proposal with the SEC—historically the vast majority of companies exclude shareholder proposals only after receiving no-action relief.

This proxy season, Rule 14a-8(i)(9) has been subject to an unusual level of attention as a number of companies have sought to rely on the exclusion to omit proxy access shareholder proposals. In a letter dated December 1, 2014, Whole Foods received no-action relief from the staff to exclude

a shareholder proposal to allow proxy access for a group of shareholders owning 3% of the company's shares for three years on the basis that it would conflict with the company's proposal to provide proxy access for a single shareholder owning 9% of the company's shares for five years. This letter generated a great deal of discussion about the application of Rule 14a-8(i)(9) to proxy access proposals, and resulted in requests from both the proponent and others, including the Council of Institutional Investors, for SEC review of the staff's position.

## SEC TO REVISIT EXCLUSION RULE

On January 16, 2015, the SEC issued a statement from Chair Mary Jo White directing the SEC staff to review the application of Rule 14a-8(i)(9). While the statement does not mention Whole Foods or the many other pending proxy access no-action letters directly, the statement notes that Chair White is requesting the review “[d]ue to questions that have arisen about the proper scope and application” of the rule.


Concurrently with the chair's statement, the SEC's Division of Corporation Finance announced that it will express no views on the application of Rule 14a-8(i)(9) during the current proxy season. As a result, the staff will not be providing no-action relief for the many pending no-action requests relating to proxy access proposals or for any other pending no-action requests relying on Rule 14a-8(i)(9).

The staff's decision not to provide no-action relief for conflicting shareholder proposals this season has left many companies scrambling to revise their plans for how to respond to a shareholder proposal that they previously planned to omit in reliance on Rule 14a-8(i)(9).

At the same time that these companies are struggling with how to respond to shareholder proposals on proxy access, institutional investors are approaching other companies to encourage them to take steps proactively to implement proxy access. The double-barreled pressure of formal proposals and informal engagement could lead to a sea change in practice, not unlike what has transpired in the recent past with respect to poison pills, classified boards and majority voting. ■



## 8 The Use of Social Media in Contested Situations

 Many public companies now consider social media to be an essential element of their shareholder communications. As companies and shareholders become more comfortable with social media as a form of communication, this trend will almost certainly continue. At the same time, social media has also become an increasingly important and visible tool for activist shareholders seeking to pressure public companies. In addition to making effective use of social media for their own purposes, public companies need to consider how social media can be used against them by dissident shareholders and how best to defend against activist attacks, while still complying with the federal securities laws.

### REGULATION FD

Regulation FD prohibits a public company from disclosing material nonpublic information to securities market professionals and other specified persons unless the company also discloses the information publicly. The SEC's principal guidance on electronic communications, issued in 2008, states that when evaluating whether a communication is sufficient under Regulation FD, a company must consider whether:

- the communication is made via a recognized channel of distribution;
- the means of communication disseminates the information in a manner that makes it available to the securities marketplace in general; and
- there has been a reasonable waiting period for investors and the market to react to the information.

In April 2013, upon the conclusion of a Regulation FD enforcement investigation involving Netflix, the SEC issued a report confirming that public companies can use social media to disseminate material information in a manner that satisfies Regulation FD if that usage complies with the principles outlined in the SEC's 2008 guidance. The report emphasized that the required analysis must be made on a case-by-case basis and highlighted some factors that may be especially relevant in the social media context, including providing appropriate notice to investors about:

- the specific social media channels the company will use for the dissemination of information, so that investors are in a position to subscribe, join, register for or otherwise review those particular channels; and
- the types of information that may be disclosed through these channels.

### IMPACT OF FEDERAL PROXY RULES

The use of social media in contested situations must also take into account the federal proxy rules, which govern all proxy solicitations. "Solicitation" is defined quite broadly, and any communication intended to influence shareholder votes may be subject to the filing and disclosure requirements of the proxy rules.

In general, proxies may not be solicited until shareholders receive a proxy statement providing the information required by the federal proxy rules. However, under Rule 14a-12, written soliciting materials (including social media communications) may be used before the filing of a proxy statement if no proxy card is furnished until a proxy statement is provided. The soliciting materials must:

- identify and provide certain information about the participants in the solicitation, including information about their ownership interests;
- include a prominent legend (which, as discussed below, may now be provided via hyperlink) that advises shareholders to read the proxy statement when it becomes available and explains where shareholders can get the proxy statement; and
- be filed with the SEC no later than the date they are first sent or given to shareholders.

In addition, Rule 14a-9 prohibits material misstatements and omissions in proxy materials (including soliciting materials permitted under Rule 14a-12).

### NEW SEC GUIDANCE

In April 2014, the SEC staff issued new guidance that makes it easier to use social media in connection with proxy solicitations. The federal securities laws and SEC rules allow companies and other parties to provide written communications

outside the proxy statement if the communication includes a specific legend. Prior to the new staff guidance, the legend requirements restricted the ability of companies and other parties to use certain types of social media—Twitter in particular—because the required legend would exceed the character limit of the communication platform.

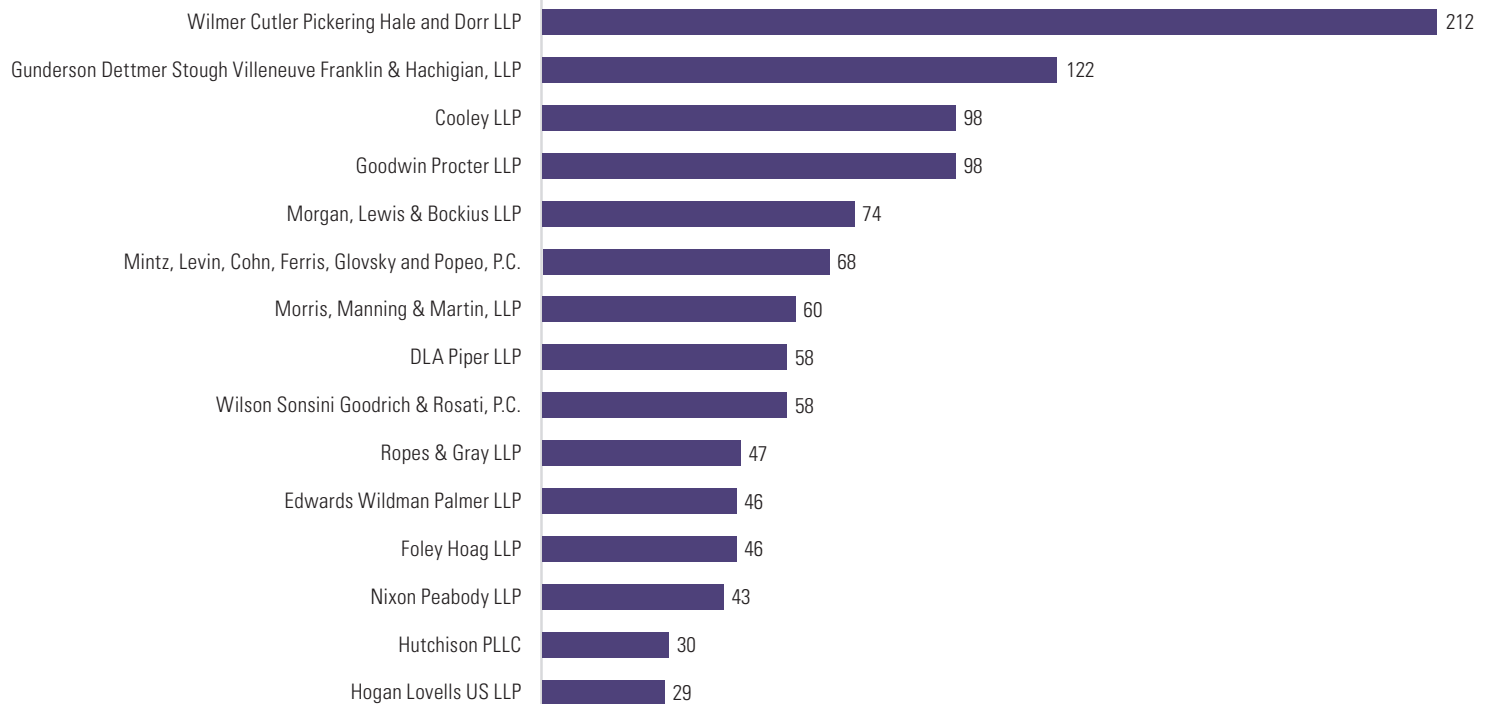
Under the new guidance, companies can satisfy the legend requirements applicable to proxy solicitations (as well as business combinations, tender offers and registered securities offerings) by including an active hyperlink that takes the reader to the full text of the required legend and prominently conveys, through introductory language or otherwise, that important or required information is provided through the hyperlink. To rely on the guidance, the communication must be distributed through a platform that has technological limitations such that including the required statements in their entirety, together with the other information, would cause the communication to exceed the limit on the number of characters or amount of text that may be included in the communication.

The new guidance provides companies with enhanced ability to use social media to reach shareholders in advance of a shareholder vote, but also enables activist investors to use social media to more effectively get their message out in proxy contests or hostile tender offers.

### CONCLUSION

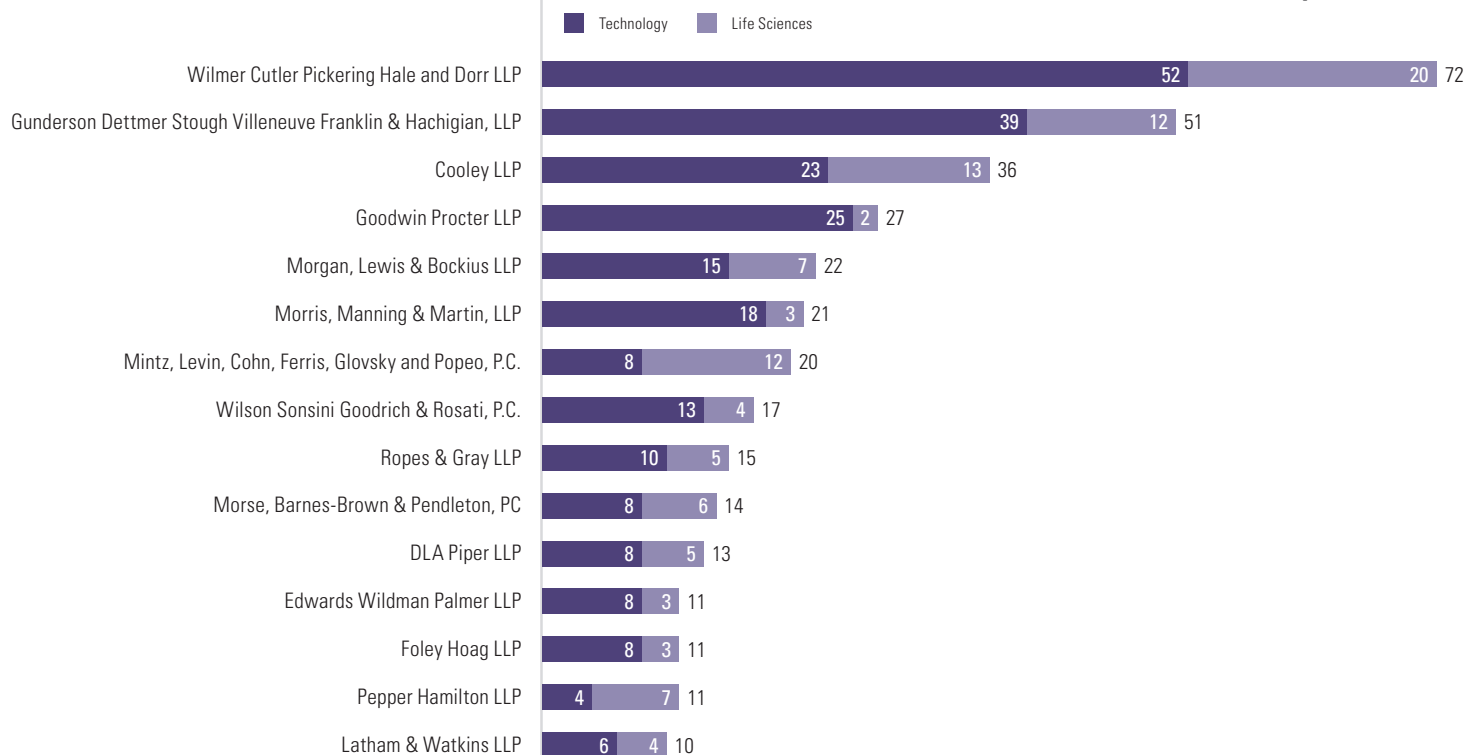
The SEC's guidance provides a useful framework for companies that wish to expand the manner and forms of their public communications. Companies should carefully consider how social media fits in with their overall shareholder communications strategy, including in both ordinary-course communications and contested situations. In the context of a proxy contest or other shareholder vote, companies must remember that the federal proxy rules apply to social media in the same way that they apply to any other written communication, and should be prepared for the possibility that social media will be used by activist investors to advance their cause. ■

### Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2014



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 2014































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


# Counsel of Choice for Mergers and Acquisitions

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



|   |  |   |   |   |   |  |
|---|--|---|---|---|---|--|
| <br><br><i>Acquisition of<br/>Office Depot</i><br><b>\$6,300,000,000</b><br><i>Pending<br/>(as of February 27, 2015)</i> | <br><br><i>Acquisition of<br/>Hittite Microwave</i><br><b>\$2,500,000,000</b><br><i>July 2014</i>   | <br><br><i>Acquisition of<br/>Telerik</i><br><b>\$262,500,000</b><br><i>December 2014</i>                                  | <br><br><i>Acquisition by<br/>BATS Global Markets</i><br><b>Undisclosed</b><br><i>January 2014</i> | <br><br><i>Sale of cell culture, gene modulation<br/>and magnetic beads businesses to<br/>GE Healthcare</i><br><b>\$1,060,000,000</b><br><i>March 2014</i> | <br><br><i>Acquisition of<br/>Intellinx</i><br><b>\$66,700,000</b><br><i>January 2015</i>                                  | <br><br><i>Acquisition of<br/>Evolution1</i><br><b>\$532,500,000</b><br><i>July 2014</i>                |
| <br><br><i>Acquisition by<br/>Nicox</i><br><b>\$120,000,000</b><br><i>(including earnout payments)<br/>October 2014</i>  | <br><br><i>Acquisition by<br/>Google</i><br><b>Undisclosed</b><br><i>May 2014</i>  | <br><br><i>Acquisition by<br/>Cynosure</i><br><b>\$294,000,000</b><br><i>June 2013</i>                                     | <br><br><i>Acquisition by<br/>Zynga</i><br><b>\$527,000,000</b><br><i>February 2014</i>            | <br><br><i>Sale of Angel.com to<br/>Genesys Telecommunications</i><br><b>\$111,000,000</b><br><i>March 2013</i>  | <br><br><i>Acquisition of the BuyDomains<br/>business of<br/>NameMedia</i><br><b>\$44,900,000</b><br><i>September 2014</i> | <br><br><i>Acquisition of<br/>Prolexic Technologies</i><br><b>\$403,000,000</b><br><i>February 2014</i> |
| <br><br><i>Sale of Campus Solutions<br/>business to<br/>Higher One</i><br><b>\$47,250,000</b><br><i>May 2013</i>       | <br><br><i>Acquisition of<br/>Tomax</i><br><b>\$75,000,000</b><br><i>(including contingent payments)<br/>January 2015</i>                   | <br><br><i>Acquisition by<br/>Lanyon</i><br><b>Undisclosed</b><br><i>April 2014</i>                                      | <br><br><i>Acquisition by<br/>Actavis</i><br><b>\$760,000,000</b><br><i>November 2014</i>        | <br><br><i>Acquisition of<br/>Rempex Pharmaceuticals</i><br><b>\$474,000,000</b><br><i>(including milestone payments)<br/>December 2013</i>              | <br><br><i>Acquisition by<br/>Samsung</i><br><b>Undisclosed</b><br><i>February 2015</i>                                  | <br><br><i>Acquisition of<br/>Ultrasonix Medical</i><br><b>\$83,000,000</b><br><i>March 2013</i>      |
| <br><br><i>Acquisition by<br/>Millennial Media</i><br><b>\$107,500,000</b><br><i>December 2014</i>                     | <br><br><i>Acquisition of the Multitest and ECT<br/>businesses of<br/>Dover Corporation</i><br><b>\$93,500,000</b><br><i>December 2013</i> | <br><br><i>Acquisition by<br/>Rovi</i><br><b>\$75,000,000</b><br><i>(including milestone payments)<br/>February 2014</i> | <br><br><i>Acquisition by<br/>Pluralsight</i><br><b>\$75,000,000</b><br><i>November 2014</i>     | <br><br><i>Acquisition of<br/>Drivers History</i><br><b>Undisclosed</b><br><i>November 2014</i>  | <br><br><i>Acquisition of<br/>Performance Technologies</i><br><b>\$50,000,000</b><br><i>February 2014</i>                | <br><br><i>Acquisition of<br/>Inktank Storage</i><br><b>\$175,000,000</b><br><i>April 2014</i>        |

## 12 Merger Control Trends Every Dealmaker Needs to Know

 Developments in merger control around the world over the past five years increasingly affect not only strategic transactions, but routine financial transactions. It is more important than ever that companies and their counsel be aware of the potential impact of merger control requirements on their transactions and, particularly in strategic and multi-jurisdictional transactions, take into consideration the timing and valuation implications of those requirements.

### SPREADING GLOBALLY

Today, approximately 90 jurisdictions have some form of merger control, most of them mandatory and suspensory, preventing at least local closing until any review is complete. Some of these regimes are quite sophisticated and fairly efficient; others are quite new and have faced steep learning curves. The parties need to determine as early as possible where a transaction may be required to be reported, since that could affect the timing of the consummation of the transaction.

### FOCUSING LOCALLY

Many jurisdictions are mainly focused on the local effects of a reported transaction. Moreover, some jurisdictions have specific issues—such as employment levels—that are also considered as part of the merger control review. In each jurisdiction in which a filing is required, it is important to identify the factors that could impair obtaining quick clearance.

### INCREASING SOPHISTICATION AND COMPLEXITY

Every jurisdiction has increased the sophistication of its analyses in recent years. Merger analysis is now far less structural than it was 10 to 15 years ago, and much more focused on the specific market facts and economics of the transaction under review. This is both good news and bad news for transactions subject to review. On one side, it means that in most jurisdictions, relatively high market shares or high market concentration alone do not necessarily indicate trouble for the transaction. However, the price of this move from structuralism is a more intense, lengthy and expensive review process focused on complex analysis of industry data and, in an increasing number of

jurisdictions, close review of documents from the parties and even third parties. Further, jurisdictional differences make an accurate risk assessment more challenging.

### SIGNIFICANT TIMING IMPLICATIONS AND UNCERTAINTY

Almost any filing requirement will affect the timing of a transaction, regardless of whether it raises any substantive issue. A filing in a suspensory jurisdiction requires the parties to wait to close until clearance is obtained. While the time is likely to be relatively short in non-strategic transactions, the filing still prevents a sign and close, and requires that financing arrangements and communications plans take into account the delayed closing. And even in non-strategic transactions, there can be some uncertainty on when clearance will be obtained.

In strategic transactions, timing issues are much more complex. The first issue is where the transaction is reportable. Some jurisdictions have strict investigative timetables and stick to them, but an increasing number of regimes have timing flexibility for investigators. For example, some agencies vary the time they take to declare the filing complete or accepted, while others sometimes “stop the clock” on the review process to give more time for investigation. The second issue is how likely the transaction is to be subject to an extended investigation.

M&A parties and their counsel need a strong sense of the answer to both these issues at a fairly early stage in the negotiation of the transaction. Mergers likely to draw extensive regulatory attention that must be filed in jurisdictions where the review is likely to be lengthy—up to a year, and sometimes more—face complex issues regarding financing, employment and customer retention and transition planning that should be considered before finalizing the transaction.

### MERGER CONTROL RISK ALLOCATION

Allocation of the risks created by merger control have become a significant part of the negotiation of many acquisitions. Companies and bankers are increasingly realizing that the level of risk can affect valuation, particularly where there are multiple suitors for a seller, and sellers

increasingly understand that they face significant risks during lengthy reviews, particularly where there is the potential that the deal may be blocked. Unsurprisingly, sellers increasingly want some protection from the risk created by transactions that create serious merger control risk. Risk allocation most commonly occurs in the following ways:

- The seller accepts the risk in exchange for a higher purchase price. This can create issues for the buyer when shareholders assert that the buyer overpaid, and can impact the economics of the transaction.
- The buyer accepts all of the risk through what is known as a “hell or high water” provision that requires it to complete the deal no matter what it has to do in order to obtain clearance.
- The buyer agrees to provide the seller with a large payment, known as a reverse breakup fee, that both provides the seller with some recompense if the deal does not close and provides a strong incentive for the buyer to complete the deal. Such fees are typically in the range of 4–5% of the transaction value.
- The buyer agrees to accept the risk up to a specific limit, expressed in terms of money to be expended, facilities to be divested, or behavioral modifications to be accepted. These provisions can be quite contentious and have an uncertain impact on reviewing agencies.

Risk can be managed in other ways as well, including short termination dates and other covenants that may be more subtle. Of course, the earlier the parties have a risk analysis in hand, the better able they are to negotiate these issues effectively and completely.

### CONCLUSION

Merger control is an increasing part of the M&A landscape. In any deal, it is important to understand what filing requirements might be triggered and what impact those requirements will have on deal timing, and in strategic deals it is more important than ever to understand the risks merger control imposes. The earlier the parties have information on these two aspects, the more effectively they can address them before merger control becomes a crisis. ■





In November 2014, the Delaware Chancery Court issued an opinion in *Cigna Health and Life Insurance Co. v. Audax Health Solutions, Inc.*, that has significant implications for private-company acquisitions structured as mergers, as is often the case with acquisitions of VC-backed companies.

## BACKGROUND

The case involved the acquisition of Audax Health Solutions by Optum Services, Inc., through the merger of Audax with an Optum subsidiary. Following approval of the merger by Audax's board, the merger was approved by written consent of 66.9% of Audax's stockholders. Cigna, an Audax stockholder, did not vote in favor of the merger.

The terms of the merger agreement conditioned receipt of the merger consideration on surrender of shares and execution of a letter of transmittal "in form and substance reasonably acceptable" to Optum.

The letter of transmittal sent to former Audax stockholders (including Cigna) included:

- a release of claims against Optum, which was not mentioned in the merger agreement;
- an agreement to be bound by the provisions of the merger agreement indemnifying Optum for breaches of representations and warranties, with the indemnification obligations for specified "fundamental representations" surviving indefinitely and not capped in dollar amount, and establishing a post-closing escrow of a portion of the merger consideration to secure the indemnification obligations; and
- the appointment of a third party to act as the representative of the former Audax stockholders in connection with post-closing indemnification claims.

Cigna refused to sign the letter of transmittal, and brought suit against Audax and other defendants, demanding payment of \$46 million in merger consideration and asserting that the provisions of the letter of transmittal violated the Delaware General Corporation Law.

## THE COURT'S DECISION

The court held that the obligation to deliver a release as part of the letter of transmittal was unenforceable because the obligation was a new obligation that the defendants sought to impose without providing anything new to Cigna beyond the merger consideration to which it had already become entitled when the merger was consummated and Cigna's shares were canceled. The court noted that the merger agreement contained no indication to stockholders that they might have to agree to the release called for in the letter of transmittal.

The court also held that the indemnification obligations that were not limited in dollar amount or time were unenforceable against non-consenting stockholders because such obligations "render the merger consideration unknowable" in violation of Section 251(b) of the Delaware General Corporation Law, which requires a merger agreement to set forth "determinable merger consideration."

Importantly, however, the court noted that Delaware case law contains no indication that an escrow of a portion of the merger consideration, as a general matter, is invalid. The court did not address the enforceability of the appointment of the stockholder representative.

## KEY LESSONS

The *Cigna* decision offers key lessons on how to structure merger agreements to maximize the likelihood of achieving the benefits the parties think they have bargained for:

- Broad indemnity obligations and releases should be enforceable where stockholders contractually agree to those obligations, either by executing the merger agreement directly or executing joinder agreements.
- Escrow arrangements and purchase price adjustments appear to be on reasonably safe ground in Delaware, but purchasers should try to maximize the enforceability of these arrangements by drafting them as contingent consideration provisions, as opposed to "clawback" provisions.
- In order to increase the enforceability of releases and other terms included

in letters of transmittal, parties should consider attaching the form of letter of transmittal as an exhibit to the merger agreement, and receipt of merger consideration should be conditioned expressly on delivery of the agreed form of letter of transmittal.

- If releases are critical, purchasers should consider allocating a portion of the deal consideration to consideration for their delivery.
- Purchasers should avoid drafting merger agreements that purport to bind non-consenting stockholders to uncapped indemnification obligations that survive indefinitely, to avoid the possibility of undermining the enforceability of more limited indemnification obligations or escrow arrangements, or should at least put such broader indemnification provisions in a separate provision and include severability clauses.
- If enforceability of clawback obligations is important to the parties, the parties should consider including a stockholder approval closing condition that requires approval of the merger agreement (including any such clawback obligations) by a higher percentage of outstanding shares than the minimum percentage required under the target company's charter documents and Delaware law.
- Parties should consider whether consenting stockholders (or a subset of the principal stockholders) should be obligated to make the buyer whole to the extent an indemnification obligation of a non-consenting stockholder is determined to be unenforceable.
- Parties should consider whether a representation and warranty insurance policy would be an attractive option as a source of recovery of indemnification claims in excess of the indemnity escrow, particularly when there is a substantial risk that a significant portion of target stockholders will not consent to the merger.
- VCs and founders should consider the scope and structure of drag-along rights in their financing documents to maximize the number of stockholders who would be contractually obligated to consent to be bound by the indemnification obligations approved by the VC or founder in a sale transaction. ■



## 14 Pre-IPO Acquisition Challenges



Private companies often make acquisitions before pursuing an IPO. Some deals occur in the ordinary course of business, before a company has given much thought to the possibility of an IPO, while others may be specifically intended to achieve critical mass in the company's revenues or to fill a gap in its product line or technology base in anticipation of going public.

In most situations, an acquisition demands significant time and attention from the acquirer's management. In the context of an IPO, many of the business challenges associated with M&A transactions are exacerbated:

- **Management Distraction:** IPO preparations alone give company management a full platter. Layering on an acquisition can make it overflow. Thoughtful allocation of management's time is needed to avoid doing a disservice to both the acquisition and the IPO, not to mention the company's business. Even with careful planning, pursuing a significant acquisition and an IPO concurrently is likely to slow down the IPO process.
  - **Integration:** Business integration takes on a heightened importance in the crucible of an IPO. Many IPO companies are already in the midst of rapid organic growth. The additional challenge of simultaneously integrating a separate organization will increase the strain on the company—even more if product integration, facility closings or employee layoffs are involved. A pre-IPO acquisition may also create additional risk during the first quarters following completion of the IPO, when the company must crisply execute its business plan and achieve its forecasted earnings.
  - **Structuring:** The issuance of private company stock as part of an acquisition purchase price can influence the manner in which an acquisition is structured. For example, stock cannot be issued as part of the acquisition unless exemptions from registration are available under federal securities laws. Whether stock or cash is used in an acquisition, the accounting treatment may make earnings impracticable for a company going public. If the target is a venture capital-backed company, additional challenges may be posed.
- The accounting aspects of any proposed acquisition are vital considerations in deal timing, structure and even feasibility. This is especially true when an acquisition is undertaken on the cusp of an IPO. Key accounting issues arising in pre-IPO acquisitions include:
- **Financial Statements:** SEC rules may require a company going public to include in its Form S-1 registration statement separate financial statements and pro forma financial information for completed and probable acquisitions. Depending on the significance of an acquisition, the required financial information may include audited historical financial statements for the target, as well as pro forma combined financial information for the acquirer and the target. If concurrent M&A activity is underway, the unavailability of all required financial information of the target could lead to significant delays in the company's IPO plans.
  - **Acquisition Accounting:** The "fair value" acquisition accounting standard has a number of implications for companies engaging in M&A activity, including P&L charges for transaction expenses and the possibility of additional and unpredictable P&L charges in future periods. Companies going public must be attentive to these matters, because of the need to demonstrate strong earnings at the time of an IPO and the desire to produce steady earnings growth in the period following the completion of the IPO. As a result, more extensive due diligence, by both the acquirer and the underwriters, is often required.
  - **SOX 404:** Section 404 of the Sarbanes-Oxley Act poses several challenges in the pre-IPO M&A context. For example, the acquirer and target are likely to have systems of financial controls that differ from each other, especially in the area of information technology. After the transaction is completed, the acquirer—once it becomes subject to Section 404 (generally upon filing its second Form 10-K after the IPO)—will have to evaluate its internal control over financial reporting (ICFR), report on

the results and (unless it qualifies as an emerging growth company under the JOBS Act) have its ICFR audited. If the combined company's system of controls is not fully integrated, it may be prone to a material weakness of ICFR that has to be disclosed. For a private acquirer that does not yet possess a fully developed internal control system, integration may require the acquirer not only to convert the target's systems but also to design or upgrade new systems.

M&A activity also has several other potential consequences for the IPO process:

- **Disclosure to Target:** The company's IPO plans may constitute material information, requiring disclosure to the target's stockholders, or the company may wish to share this information—in a balanced manner—to make its stock more attractive to the target stockholders. The company's disclosure of its upcoming IPO to an acquisition target poses at least some risk of premature public dissemination of the company's IPO plans.
- **Form S-1 Disclosure:** The company will be obligated to disclose its acquisition activity in the Form S-1 if a completed or probable acquisition triggers a requirement for separate target financial statements or prompts MD&A disclosure, a significant portion of the IPO proceeds will be used to finance an acquisition, or a large potential transaction is otherwise material for securities law purposes.
- **Due Diligence:** M&A transactions during the IPO process will result in additional due diligence by the underwriters and their counsel and can affect the timing of the IPO.

Pre-IPO acquisitions can present significant complications for the going-public process. The company must balance the strategic benefits of a proposed acquisition against its potentially detrimental impact on the IPO. Although proceeding with both plans at the same time is usually feasible and sometimes necessary, the company must be prepared for the possibility that doing so will require extra effort and create incremental risk or delay for each. ■



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 circulate a proxy statement for stockholder approval (unless a tender offer structure is used), and the need in many public company acquisitions for antitrust clearances that may not be required in smaller, private company deals.
- **Confidentiality:** The potential damage from a leak is much greater in an M&A transaction involving a public company, and accordingly rigorous confidentiality precautions are taken.
- **Director Liability:** The board of a public target will almost certainly obtain a fairness opinion from an investment banking firm and is much more likely to be challenged by litigation alleging a breach of fiduciary duties.

## DUE DILIGENCE

When a public company is acquired, the due diligence process differs

from the process followed in a private company acquisition:

- **Availability of SEC Filings:** Due diligence typically starts with the target's SEC filings—enabling a potential acquirer to investigate in stealth mode until it wishes to engage the target in discussions.
- **Speed:** The due diligence process is often quicker in an acquisition of a public company because of the availability of SEC filings, thereby allowing the parties to focus quickly on the key transaction points.

## MERGER AGREEMENT

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

- **Representations:** In general, the representations and warranties from a public company are less extensive than those from a private company; are tied in some respects to the accuracy of the public company's SEC filings; may have higher materiality thresholds; and, importantly, do not survive the closing.
- **Exclusivity:** The exclusivity provisions are subject to a "fiduciary exception" permitting the target to negotiate with a third party making an offer that may be deemed superior and to change the target board's recommendation to stockholders.
- **Closing Conditions:** The closing conditions in the merger agreement, including the "no material adverse change" condition, are generally tightly drafted in public company deals, and give the acquirer little room to refuse to complete the transaction if regulatory and stockholder approvals are obtained.
- **Post-Closing Obligations:** Post-closing escrow or indemnification arrangements are very rare.
- **Earnouts:** Earnouts are unusual, although a form of earnout arrangement called a "contingent value right" is not uncommon in the biotech sector.
- **Deal Certainty and Protection:** The negotiation battlegrounds are the provisions addressing deal certainty (principally the closing conditions) and deal protection (exclusivity, voting agreement, termination and breakup fees).

## SEC INVOLVEMENT

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

- **Form S-4:** In a public deal, if the acquirer is issuing stock to the target's stockholders, the acquirer must register the issuance on a Form S-4 registration statement that is filed with (and possibly reviewed by) the SEC.
- **Stockholder Approval:** Absent a tender offer, the target's stockholders, and sometimes the acquirer's stockholders, must approve the transaction. Stockholder approval is sought pursuant to a proxy statement that is filed with (and possibly reviewed by) the SEC. In addition, public targets generally must provide for a separate, non-binding stockholder vote with respect to all compensation each named executive officer will receive in connection with 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 2013. The ABA private target study covers acquisitions that were completed in 2012, and the ABA public target study covers acquisitions that were announced in 2013 (excluding acquisitions by private equity buyers).

## 16 A Comparison of Deal Terms in Public and Private Acquisitions

### COMPARISON OF SELECTED DEAL TERMS

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

- **“10b-5” Representation:** A representation to the effect that no representation or warranty by the target contained in the acquisition agreement, and no statement contained in any document, certificate or instrument delivered by the target pursuant to the acquisition agreement, contains any untrue statement of a material fact or fails to state any material fact necessary, in light of the circumstances, to make the statements in the acquisition agreement not misleading.
- **Standard for Accuracy of Target Reps at Closing:** The standard against which the accuracy of the target’s representations and warranties is measured for purposes of the acquirer’s closing conditions:
  - A “MAC/MAE” standard provides that each of the representations and warranties of the target set forth in the acquisition agreement must be true and correct in all respects as of the closing, *except where the failure of such representations and warranties to be true and correct will not have or result in a material adverse change/effect on the target.*
  - An “in all material respects” standard provides that the representations and warranties of the target set forth in the acquisition agreement must be true and correct *in all material respects* as of the closing.
  - An “in all respects” standard provides that each of the representations and warranties of the target set forth in the acquisition agreement must be true and correct *in all respects* as of the closing.
- **Inclusion of “Prospects” in MAC/MAE Definition:** Whether the “material adverse change/effect” definition in the acquisition agreement includes “prospects” along with other target

metrics, such as the business, assets, properties, financial condition and results of operations of the target.

- **Fiduciary Exception to “No-Talk” Covenant:** Whether the “no-talk” covenant prohibiting the target from seeking an alternative acquirer includes an exception permitting the target to consider an unsolicited superior proposal if required to do so by its fiduciary duties.
- **Opinion of Target’s Counsel as Closing Condition:** Whether the acquisition agreement contains a closing condition requiring the target to obtain an opinion of counsel, typically addressing the target’s due organization, corporate authority and capitalization; the authorization and enforceability of the acquisition agreement; and whether the transaction violates the target’s corporate charter, by-laws or applicable law. (Opinions regarding

the tax consequences of the transaction are excluded from this data.)

- **Appraisal Rights Closing Condition:** Whether the acquisition agreement contains a closing condition providing that appraisal rights must not have been sought by target stockholders holding more than a specified percentage of the target’s outstanding capital stock. (Under Delaware law, appraisal rights generally are not available to stockholders of a public target when the merger consideration consists solely of publicly traded stock.)
- **Acquirer MAC/MAE Termination Right:** Whether the acquisition agreement contains a closing condition permitting the acquirer to terminate the agreement if an event or development has occurred that has had, or could reasonably be expected to have, a “material adverse change/effect” on the target.

#### “10b-5” Representation

|                       |     |
|-----------------------|-----|
| PUBLIC (ABA)          | 2%  |
| PRIVATE (ABA)         | 36% |
| PRIVATE (SRS ACQUIOM) | 48% |

#### Standard for Accuracy of Target Reps at Closing

|                            |      |
|----------------------------|------|
| PUBLIC (ABA)               |      |
| “MAC/MAE”                  | 93%  |
| “In all material respects” | 3%   |
| Other standard             | 4%   |
| PRIVATE (ABA)              |      |
| “MAC/MAE”                  | 47%  |
| “In all material respects” | 53%  |
| “In all respects”          | None |
| PRIVATE (SRS ACQUIOM)      |      |
| “MAC/MAE”                  | 36%  |
| “In all material respects” | 58%  |
| “In all respects”          | 6%   |

#### Inclusion of “Prospects” in MAC/MAE Definition

|                       |     |
|-----------------------|-----|
| PUBLIC (ABA)          | 1%  |
| PRIVATE (ABA)         | 17% |
| PRIVATE (SRS ACQUIOM) | 11% |

#### Fiduciary Exception to “No-Talk” Covenant

|                       |     |
|-----------------------|-----|
| PUBLIC (ABA)          | 99% |
| PRIVATE (ABA)         | 15% |
| PRIVATE (SRS ACQUIOM) | 6%  |

#### Opinion of Target’s Counsel as Closing Condition

|                       |     |
|-----------------------|-----|
| PUBLIC (ABA)          | —   |
| PRIVATE (ABA)         | 19% |
| PRIVATE (SRS ACQUIOM) | 38% |

#### Appraisal Rights Closing Condition

|                            |     |
|----------------------------|-----|
| PUBLIC (ABA)               |     |
| All cash deals             | 3%  |
| Part cash/part stock deals | 26% |
| PRIVATE (ABA)              |     |
| All deals                  | 54% |
| PRIVATE (SRS ACQUIOM)      |     |
| All deals                  | 50% |

#### Acquirer MAC/MAE Termination Right

|                       |     |
|-----------------------|-----|
| PUBLIC (ABA)          | 99% |
| PRIVATE (ABA)         | 94% |
| PRIVATE (SRS ACQUIOM) | 94% |

## TRENDS IN SELECTED DEAL TERMS

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

### In transactions involving public company targets:

- *“10b-5” Representations:* These representations have all but disappeared, falling from 19% of acquisitions announced in 2004 to just 2% of acquisitions announced in 2013.
- *Accuracy of Target Reps at Closing:* The MAC/MAE standard for accuracy of the target’s representations at closing is now near-universal, present in 93% of acquisitions announced in 2013 compared to 82% of acquisitions announced in 2005–2006. In practice, this trend has been offset to some extent by the use of exceptions with lower standards for specific representations.
- *Inclusion of “Prospects” in MAC/MAE Definition:* The target’s “prospects” were included in the MAC/MAE definition in only 1% of acquisitions announced in 2013, representing a sharp decline in frequency from 10% of acquisitions announced in 2004.
- *Fiduciary Exception to “No-Talk” Covenant:* The fiduciary exception in 87% of acquisitions announced in 2013 was based on the concept of “an acquisition proposal expected to result in a superior offer,” up from 79% in 2004 but down from 98% in 2012, while the standard based on the mere existence of any “acquisition proposal,” which had disappeared entirely from deals announced in 2012, was present in 9% of acquisitions in 2013. The standard based on an actual “superior offer” declined from 11% in 2004 to 4% in 2013. In practice, these trends have been partly offset by an increase in deals that contain a “back-door” fiduciary exception, such as the “whenever fiduciary duties require” standard.

- *“Go-Shop” Provisions:* The first “go-shop” provisions, granting the target a specified period of time to seek a better deal after signing an acquisition agreement, appeared in 2007, but the incidence of these provisions has increased to 6% in 2012 and 13% 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 (the first period this metric was surveyed) to 3% of cash deals in 2013. Among cash/stock deals, an appraisal rights closing condition appeared in 26% of acquisitions announced in 2013, after declining from 28% in 2005–2006 to 14% in 2012.

### In transactions involving private company targets:

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

## Post-Closing Claims

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

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



## 18 Trends in VC-Backed Company M&A Deal Terms

 We reviewed all merger transactions between 2008 and 2014 involving venture-backed targets (as reported in Dow Jones VentureSource) in which the merger documentation was publicly available and the deal value was \$25 million or more. Based on this review, we have compiled the following deal data:

| Characteristics of Deals Reviewed   |                                   | 2008      | 2009      | 2010      | 2011                   | 2012      | 2013      | 2014                   |
|---|-----------------------------------|-----------|-----------|-----------|------------------------|-----------|-----------|------------------------|
| The number of deals we reviewed and the type of consideration paid in each  | Sample Size                       | 25        | 15        | 17        | 51                     | 26        | 27        | 37                     |
|   | Cash                              | 76%       | 60%       | 71%       | 73%                    | 73%       | 59%       | 59%                    |
|   | Stock                             | 4%        | 0%        | 6%        | 4%                     | 8%        | 8%        | 3%                     |
|   | Cash and Stock                    | 20%       | 40%       | 23%       | 23%                    | 19%       | 33%       | 38%                    |
| Deals with Earnout  |                                   | 2008      | 2009      | 2010      | 2011                   | 2012      | 2013      | 2014                   |
| Deals that provided contingent consideration based upon post-closing performance of the target (other than balance sheet adjustments)           | With Earnout                      | 12%       | 27%       | 29%       | 29%                    | 31%       | 33%       | 30%                    |
|   | Without Earnout                   | 88%       | 73%       | 71%       | 71%                    | 69%       | 67%       | 70%                    |
| Deals with Indemnification  |                                   | 2008      | 2009      | 2010      | 2011                   | 2012      | 2013      | 2014                   |
| Deals where the target's shareholders or the buyer indemnified the other post-closing for breaches of representations, warranties and covenants | With Indemnification              |           |           |           |                        |           |           |                        |
|   | By Target's Shareholders          | 96%       | 100%      | 100%      | 98%                    | 100%      | 100%      | 97%                    |
|   | By Buyer <sup>1</sup>             | 48%       | 36%       | 17%       | 43%                    | 62%       | 44%       | 49%                    |
| Survival of Representations and Warranties  |                                   | 2008      | 2009      | 2010      | 2011                   | 2012      | 2013      | 2014                   |
| Length of time that representations and warranties survived the closing for indemnification purposes <sup>2</sup>                               | Shortest                          | 12 Months | 6 Months  | 9 Months  | 12 Months <sup>3</sup> | 10 Months | 12 Months | 12 Months <sup>4</sup> |
|   | Longest                           | 24 Months | 18 Months | 21 Months | 24 Months              | 24 Months | 30 Months | 24 Months              |
|   | Most Frequent                     | 12 Months | 18 Months | 18 Months | 18 Months              | 18 Months | 18 Months | 12 and 18 Months (tie) |
| Caps on Indemnification Obligations   |                                   | 2008      | 2009      | 2010      | 2011                   | 2012      | 2013      | 2014                   |
| Upper limits on indemnification obligations where representations and warranties survived the closing for indemnification purposes              | With Cap                          | 95%       | 100%      | 100%      | 100%                   | 100%      | 100%      | 100%                   |
|   | Limited to Escrow                 | 81%       | 71%       | 71%       | 77%                    | 81%       | 88%       | 89%                    |
|   | Limited to Purchase Price         | 14%       | 0%        | 6%        | 2%                     | 0%        | 0%        | 0%                     |
|   | Exceptions to Limits <sup>5</sup> | 62%       | 71%       | 94%       | 96%                    | 96%       | 100%      | 100%                   |
|   | Without Cap                       | 5%        | 0%        | 0%        | 0%                     | 0%        | 0%        | 0%                     |

<sup>1</sup> The buyer provided indemnification in 50% of the 2008 transactions, 40% of the 2009 transactions, 80% of the 2010 transactions, 29% of the 2011 transactions, 57% of the 2012 transactions, 55% of the 2013 transactions, and 53% of the 2014 transactions where buyer stock was used as consideration. In 25% of the 2008 transactions, 40% of the 2009 transactions, 33% of the 2010 transactions, 23% of the 2011 transactions, 25% of the 2012 transactions, 50% of the 2013 transactions, and 44% of the 2014 transactions where the buyer provided indemnification, buyer stock was used as consideration.

<sup>2</sup> Measured for representations and warranties generally; specified representations and warranties may survive longer.

<sup>3</sup> In one case, representations and warranties did not survive.

<sup>4</sup> In one case, general representations and warranties did not survive, but certain "fundamental" representations and warranties did survive.

<sup>5</sup> Generally, exceptions were for fraud, willful misrepresentation and certain "fundamental" representations commonly including capitalization, authority and validity. In a limited number of transactions, exceptions also included intellectual property representations.



| Escrows  |   | 2008              | 2009                   | 2010      | 2011              | 2012              | 2013              | 2014            |
|--|---|-------------------|------------------------|-----------|-------------------|-------------------|-------------------|-----------------|
| Deals having escrows securing indemnification obligations of the target's shareholders   | With Escrow   | 96%               | 93%                    | 100%      | 94%               | 100%              | 93% <sup>6</sup>  | 97%             |
|  | % of Deal Value   |                   |                        |           |                   |                   |                   |                 |
|  | Lowest  | 3%                | 10%                    | 2%        | 5%                | 5%                | 5%                | 2% <sup>7</sup> |
|  | Highest   | 15%               | 15%                    | 25%       | 31%               | 16%               | 20%               | 16%             |
|  | Most Frequent   | 10%               | 10%                    | 10%       | 10%               | 10%               | 10%               | 10%             |
|  | Length of Time  |                   |                        |           |                   |                   |                   |                 |
|  | Shortest  | 12 Months         | 12 Months              | 9 Months  | 12 Months         | 10 Months         | 12 Months         | 12 Months       |
|  | Longest   | 36 Months         | 18 Months              | 36 Months | 36 Months         | 48 Months         | 30 Months         | 24 Months       |
|  | Most Frequent   | 12 Months         | 12 and 18 Months (tie) | 18 Months | 18 Months         | 12 Months         | 18 Months         | 12 Months       |
|  | Exclusive Remedy  | 83%               | 46%                    | 53%       | 78%               | 73%               | 60%               | 86%             |
|  | Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy <sup>8</sup> | 85%               | 83%                    | 80%       | 97%               | 100%              | 100%              | 100%            |
|  |   |                   |                        |           |                   |                   |                   |                 |
| Baskets for Indemnification  |   | 2008              | 2009                   | 2010      | 2011              | 2012              | 2013              | 2014            |
| 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 <sup>9</sup>   | 43% <sup>10</sup> | 43%                    | 56%       | 38%               | 27%               | 50%               | 44%             |
|  | Threshold <sup>9</sup>  | 48% <sup>10</sup> | 57%                    | 44%       | 60%               | 65%               | 42%               | 56%             |
| MAE Closing Condition  |   | 2008              | 2009                   | 2010      | 2011              | 2012              | 2013              | 2014            |
| 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   | 88%               | 100%                   | 100%      | 98%               | 95%               | 100%              | 97%             |
|  | Condition in Favor of Target <sup>11</sup>                                | 21%               | 20%                    | 19%       | 15%               | 9%                | 17%               | 19%             |
| Exceptions to MAE  |   | 2008              | 2009                   | 2010      | 2011              | 2012              | 2013              | 2014            |
| Deals where the definition of "material adverse effect" for the target contained specified exceptions  | With Exception <sup>12</sup>  | 92%               | 93%                    | 94%       | 94% <sup>13</sup> | 84% <sup>14</sup> | 96% <sup>15</sup> | 100%            |

<sup>6</sup> One of two transactions not including an escrow at closing did require funding of escrow with proceeds of earnout payments.

<sup>7</sup> Excludes one transaction with an escrow of 0.75% which also specifically referred to representation and warranty insurance as recourse for the buyer.

<sup>8</sup> 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.

<sup>9</sup> A "hybrid" approach with both a deductible and a threshold was used in another 4% of these transactions in 2008, 2% of these transactions in 2011, 8% of these transactions in 2012, and 8% of these transactions in 2013.

<sup>10</sup> Another 4% of these transactions had no deductible or threshold.

<sup>11</sup> In 60% of these transactions in 2008, 100% of these transactions in 2009, 67% of these transactions in 2010, 86% of these transactions in 2011, 100% of these transactions in 2012, 100% of these transactions in 2013, and 86% of these transactions in 2014, buyer stock was used as consideration.

<sup>12</sup> Generally, exceptions were for general economic and industry conditions.

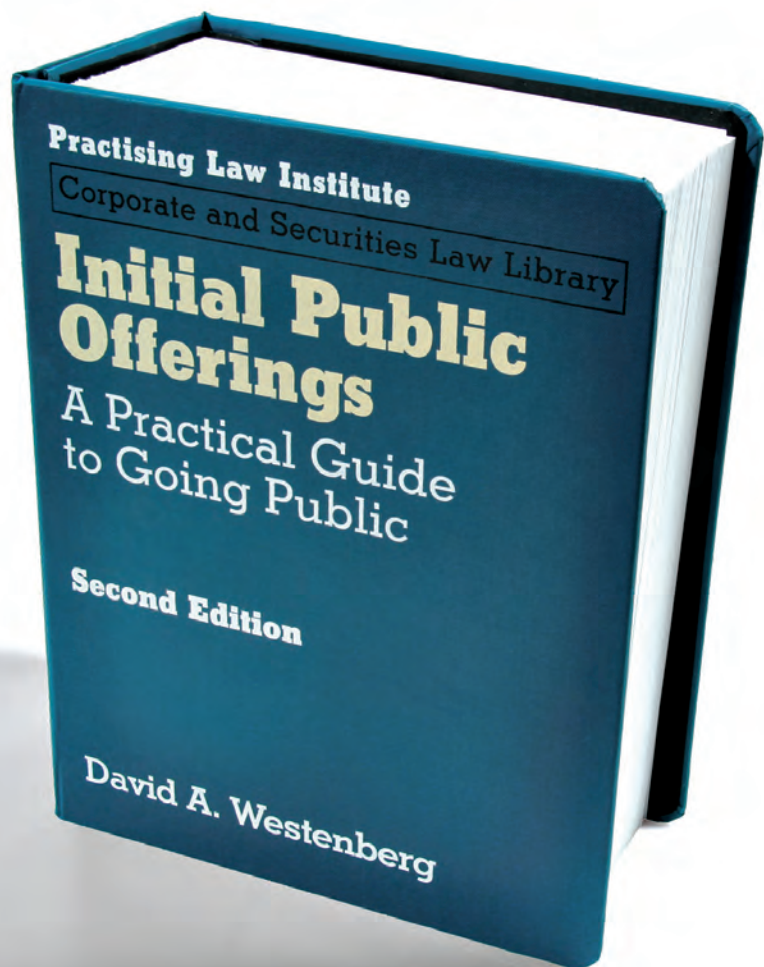
<sup>13</sup> Excludes one transaction where the specified exceptions do not apply for purposes of a standalone "material adverse effect" closing condition.

<sup>14</sup> 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.

<sup>15</sup> The only transaction not including such exceptions provided for a closing on the same day the definitive agreement was signed.

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