

# M&A Report

2020



WILMERHALE® 

## 2020 M&A Report – What’s Inside

- 2** Market Review and Outlook
- 5** Takeover Defenses: An Update
- 8** Antitrust Guidelines for Pre-Closing Activities
- 9** Law Firm Rankings
- 10** Selected WilmerHale M&A Transactions
- 12** Disclosure Considerations in Private Company Mergers
- 14** A Comparison of Deal Terms in Public and Private Acquisitions
- 17** Impact of Buy-Side Representation and Warranty Insurance on Deal Terms
- 18** Trends in VC-Backed Company M&A Deal Terms
- 20** *Initial Public Offerings: A Practical Guide to Going Public*

## 2 Market Review and Outlook

### REVIEW

With favorable macroeconomic conditions prevailing for much of 2019, high levels of cash among strategic acquirers and the Federal Reserve Bank cutting interest rates three times during the second half of the year (the first interest rate cuts since 2008), the number of reported M&A transactions and aggregate deal value worldwide both increased modestly.

The number of M&A transactions worldwide inched up less than 1%, from 50,337 deals in 2018 to 50,526 in 2019. Global M&A deal value increased by 2%, from \$3.39 trillion in 2018 to \$3.50 trillion in 2019.

The average deal size in 2019 was \$68.5 million, up by 2% from \$67.3 million in 2018 and just shy of the \$68.7 million average deal size in 2015, making it the second-highest annual figure since 2008.

The number of worldwide billion-dollar transactions declined by 6%, from 531 in 2018 to 498 in 2019—just under the average of 501 that prevailed during the five-year period from 2013 to 2017. Aggregate global billion-dollar deal value increased by 5%, from \$2.15 trillion to \$2.25 trillion.

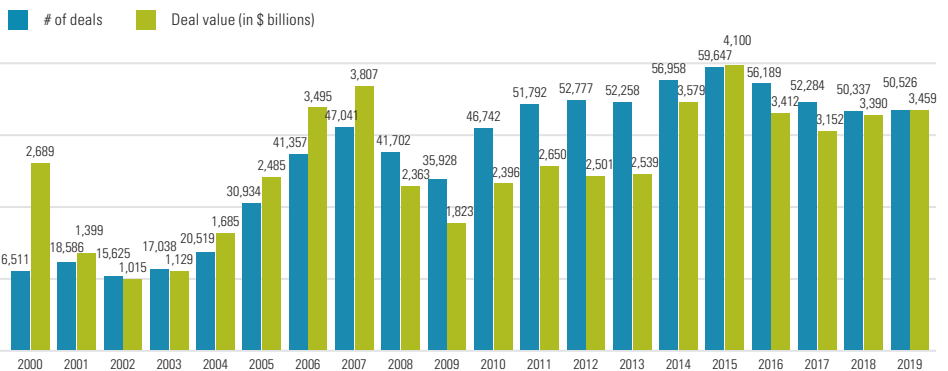
### GEOGRAPHIC RESULTS

Deal volume and aggregate deal value trends varied across geographic regions in 2019:

- **United States:** Deal volume increased by 5%, from 19,767 transactions in 2018 to 20,686 transactions in 2019. US deal value dipped by 1%, from \$2.18 trillion to \$2.16 trillion. Average deal size declined by 5%, from \$110.3 million in 2018 to \$104.3 million in 2019—still the third-highest annual average since 2007. The number of billion-dollar transactions involving US companies decreased by 11%, from 340 in 2018 to 302 in 2019, while the total value of these transactions remained steady at \$1.59 trillion.

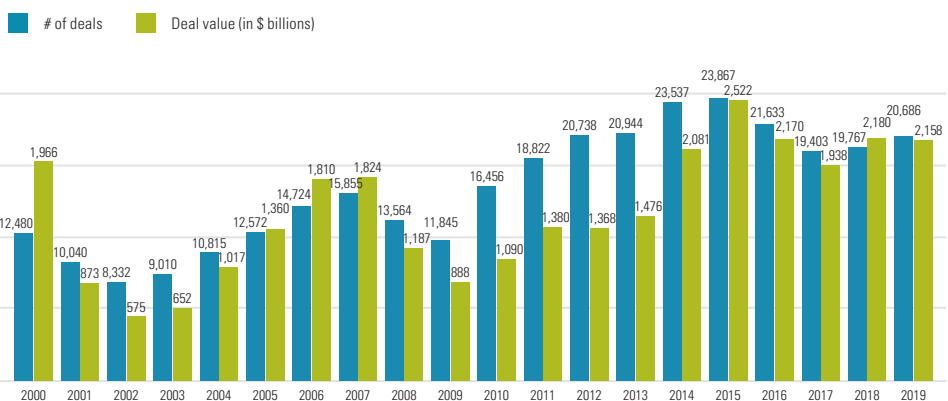
- **Europe:** The number of transactions in Europe decreased for the fourth consecutive year, by 5%, from 20,054 deals in 2018 to 19,136 deals in 2019. Total deal value fell 14%, from \$1.38 trillion in 2018 to \$1.18 trillion in 2019, while average

### Global M&A Activity – 2000 to 2019



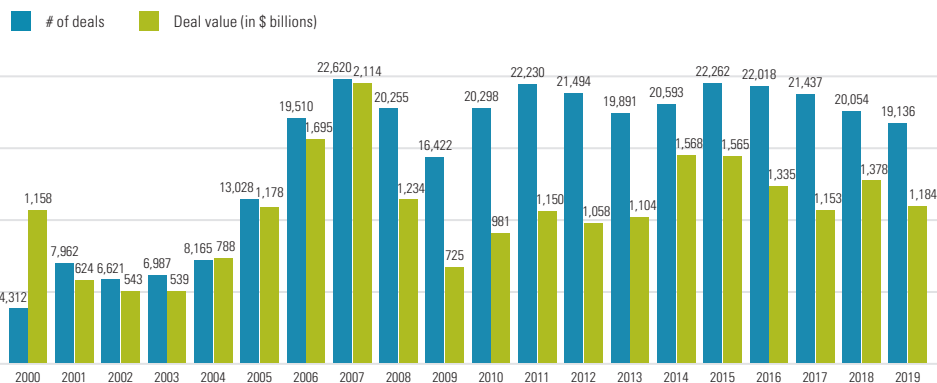
Source: S&P Global Market Intelligence

### US M&A Activity – 2000 to 2019



Source: S&P Global Market Intelligence

### European M&A Activity – 2000 to 2019



Source: S&P Global Market Intelligence

deal size declined by 10%, from \$68.7 million to \$61.9 million. The number of billion-dollar transactions involving European companies dropped by 2%,

from 205 in 2018 to 200 in 2019. The total value of billion-dollar transactions decreased by 16%, from \$937.3 billion in 2018 to \$785.9 billion in 2019.

— *Asia-Pacific:* The Asia-Pacific region saw a 2% increase in deal volume, from 11,332 transactions in 2018 to 11,544 transactions in 2019. Total deal value in the region decreased by 11%, from \$912.0 billion in 2018 to \$810.3 billion in 2019, while average deal size declined by 13%, from \$80.5 million to \$70.2 million. The number of billion-dollar transactions involving Asia-Pacific companies decreased by 5%, from 146 in 2018 to 138 in 2019, while their total value fell by 20%, from \$513.3 billion to \$411.3 billion.

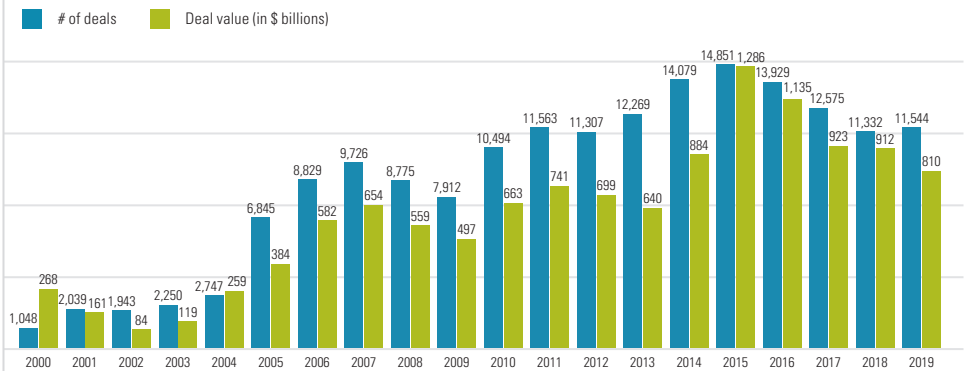
**SECTOR RESULTS**

Trends in M&A deal volume and value differed across industry sectors in 2019. Among technology and life sciences companies worldwide, transaction volume increased, and deal value and average deal size—particularly for life sciences companies—enjoyed even larger gains. In the financial services sector, global deal volume edged down, while deal value and average deal size both contracted more severely. In the telecommunications sector, global deal volume increased modestly but deal value plummeted by nearly one-half, resulting in a sharp decline in average deal size. M&A trends across sectors in the United States were largely consistent with global results.

— *Technology:* Global transaction volume in the technology sector increased by 5%, from 7,533 deals in 2018 to 7,910 deals in 2019. Global deal value grew by 21%, from \$396.2 billion to \$479.7 billion. Average deal size increased by 15%, from \$52.6 million to \$60.6 million. US technology deal volume saw an uptick of 2%, from 3,349 to 3,420 transactions. At \$386.2 billion, total 2019 US technology deal value was 25% higher than the 2018 figure of \$309.4 billion, resulting in a 22% increase in average deal size, from \$92.4 million to \$112.9 million.

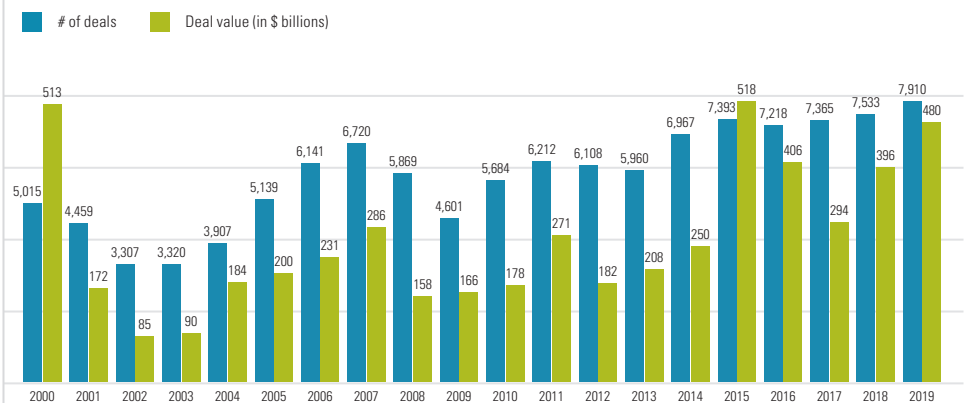
— *Life Sciences:* Global transaction volume in the life sciences sector increased by 13%, from 1,546 deals in 2018 to 1,744 deals in 2019, while global deal value surged 59%, from \$257.4 billion to \$410.1 billion—the highest recorded annual figure. Average deal size jumped by 41%, from \$166.5 million to \$235.2

**Asia-Pacific M&A Activity – 2000 to 2019**



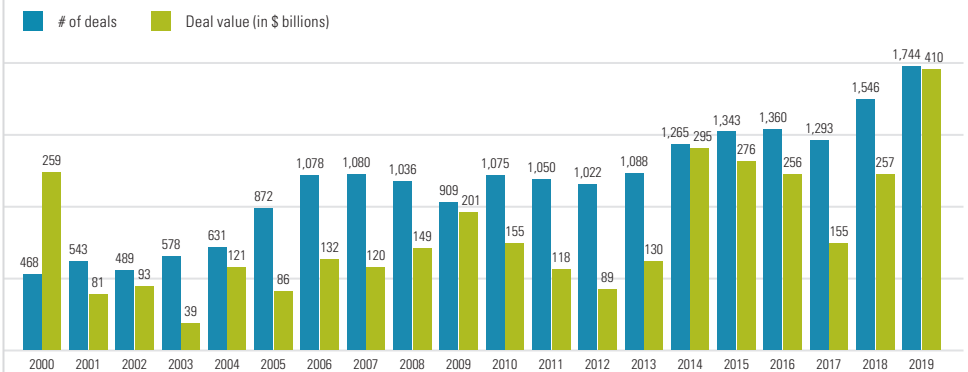
Source: S&P Global Market Intelligence

**Technology M&A Activity – 2000 to 2019**



Source: S&P Global Market Intelligence

**Life Sciences M&A Activity – 2000 to 2019**



Source: S&P Global Market Intelligence

million. In the United States, deal volume grew by 25%, from 669 to 833 transactions. Total deal value almost doubled, from \$188.2 billion to \$369.7

billion, resulting in an average deal size that, at \$443.9 million, was 58% higher than the \$281.3 million average in 2018.

## 4 Market Review and Outlook

— **Financial Services:** Global M&A activity in the financial services sector declined by 1%, from 2,841 deals in 2018 to 2,813 deals in 2019. Global deal value decreased by 27%, from \$394.6 billion to \$287.7 billion, with average deal size dropping 26%, from \$138.9 million to \$102.3 million. In the United States, financial services sector deal volume increased by less than 1%, from 1,314 to 1,323 transactions, while total deal value declined by 34%, from \$261.4 billion to \$172.9 billion. Average US deal size decreased by 34%, from \$198.9 million to \$130.7 million.

— **Telecommunications:** Global transaction volume in the telecommunications sector increased by 11%, from 620 deals in 2018 to 687 deals in 2019. Global telecommunications deal value fell by one-half, from \$188.9 billion to \$95.4 billion, resulting in a 55% decrease in average deal size, from \$304.7 million to \$138.8 million. US telecommunications deal volume increased by 10%, from 183 to 202 transactions, while total deal value dropped by 61%, from \$116.6 billion to \$45.0 billion. The average US telecommunications deal size contracted by almost two-thirds, from \$637.4 million to \$222.6 million.

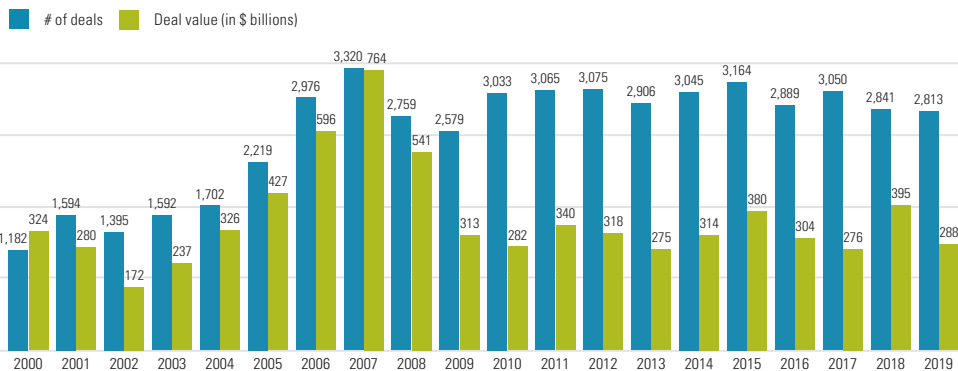
— **VC-Backed Companies:** The number of reported acquisitions of VC-backed companies declined by 7%, from 759 in 2018 to 708 in 2019. Total reported proceeds decreased by 5%, from \$129.5 billion to \$123.4 billion—still the third-highest annual figure in history.

### OUTLOOK

The outlook for the M&A market over the coming year is clouded by the impact of the COVID-19 pandemic. While some potential acquirers may struggle with the economic fallout of the pandemic and eschew acquisitions, well-funded acquirers are likely to see opportunities. Important factors that will affect M&A activity over the balance of 2020 include the following:

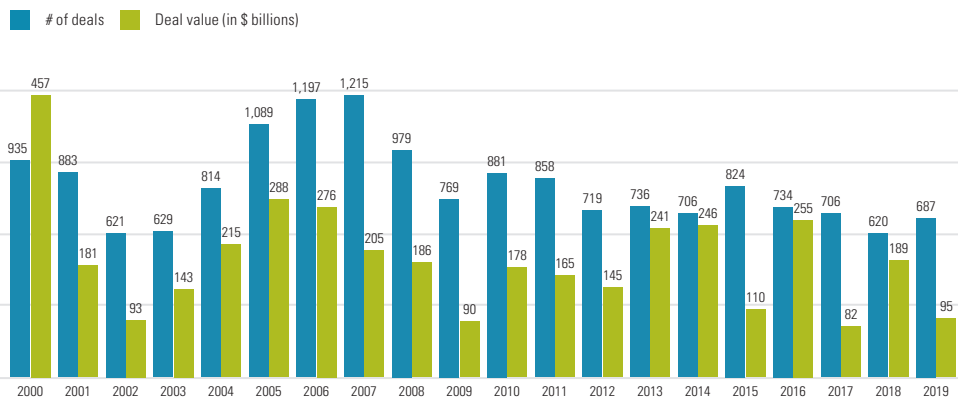
— **Macroeconomic Conditions:** The US economy entered 2020 poised for another strong year, with unemployment and interest rates at historically low levels. The outbreak of the coronavirus in the first

### Financial Services M&A Activity – 2000 to 2019



Source: S&P Global Market Intelligence

### Telecommunications M&A Activity – 2000 to 2019



Source: S&P Global Market Intelligence

quarter of 2020 inflicted an unprecedented shock on the economy, stalling growth and pushing the unemployment rate to its highest level since the Great Depression. Economic uncertainty is likely to make business projections for potential transactions more challenging and less reliable, dampening M&A activity in the short- to mid-term.

— **Valuations:** The start of 2020 saw the major stock market indices hit record highs before the fallout of the COVID-19 pandemic erased many of the gains from 2019. The sharp contraction in valuations for some publicly held targets, especially in sectors disproportionately impacted by the pandemic—such as transportation and travel and leisure—may create buying opportunities. Valuations in more attractive sectors, for both public and private companies, should fare better in the coming year.

— **Private Equity Activity:** On the buy side, private equity firms continue to hold record levels of “dry powder” to deploy. In recent years, the abundance of PE capital has intensified deal competition and contributed to higher acquisition prices. On the sell side, PE firms are facing pressure to exit investments and return capital to investors, even if investor returns are dampened by increases in the level of equity invested in acquisitions.

— **VC-Backed Company Pipeline:** In the coming year, the volume of sales of VC-backed companies will depend in large part on their valuations—which reached a record high in 2019—and the health of the IPO market. The disparity between private and public valuations and the poor aftermarket performance of some of the most prominent VC-backed IPOs of 2019 may make sales more appealing than IPOs for many VC-backed companies. ■

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

**CLASSIFIED BOARDS**

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

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

**SUPERMAJORITY VOTING REQUIREMENTS**

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

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

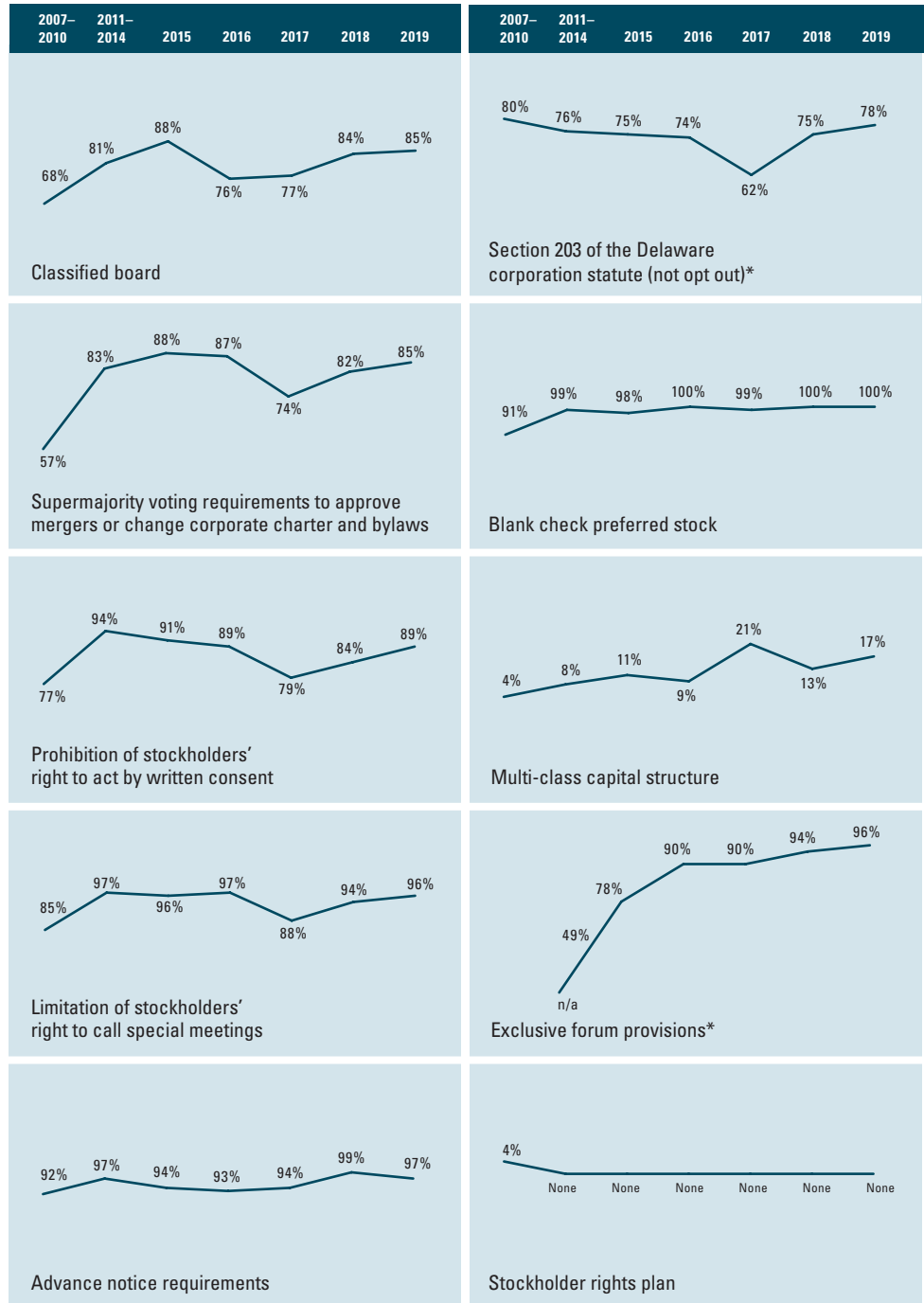
majority of the company’s stock but opposed by management and the board. In addition, opponents believe that supermajority requirements—which generally require votes of 60% to 80% of the total number of outstanding shares—can be almost impossible to satisfy because of abstentions, broker non-votes and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

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

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

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

**TRENDS IN TAKEOVER DEFENSES AMONG IPO COMPANIES**



\*Delaware corporations only  
Source: WilmerHale analysis of SEC filings from 2007 to 2019 (2011–2019 only for exclusive forum provisions) for US issuers.



## 6 Takeover Defenses: An Update

a formal meeting, but can result in a single stockholder or small number of stockholders being able to take action without prior notice or any opportunity for other stockholders to be heard. If stockholders are not permitted to act by written consent, all stockholder action must be taken at a duly called stockholders' meeting for which stockholders have been provided detailed information about the matters to be voted on, and at which there is an opportunity to ask questions about proposed business.

### LIMITATION OF STOCKHOLDERS' RIGHT TO CALL SPECIAL MEETINGS

*Should stockholders have the right to call special meetings, or should they be required to wait until the next annual meeting of stockholders to present matters for action?*

If stockholders have the right to call special meetings of stockholders, one or a few stockholders may be able to call a special meeting, which can result in abrupt changes in board composition, interfere with the board's ability to maximize stockholder value, or result in significant expense and disruption to ongoing corporate focus. A requirement that only the board or specified officers or directors are authorized to call special meetings of stockholders could, however, have the effect of delaying until the next annual meeting actions that are favored by the holders of a majority of the company's stock.

### ADVANCE NOTICE REQUIREMENTS

*Should stockholders be required to notify the company in advance of director nominations or other matters that the stockholders would like to act upon at a stockholders' meeting?*

Advance notice requirements provide that stockholders at a meeting may only consider and act upon director nominations or other proposals that have been specified in the notice of meeting and brought before the meeting by or at the direction of the board, or by a stockholder who has delivered timely written notice to the company. Advance notice requirements afford the board ample time to consider the desirability of stockholder proposals and ensure that they are consistent with the company's objectives and, in the case

## PREVALENCE OF TAKEOVER DEFENSES AMONG IPO COMPANIES AND ESTABLISHED PUBLIC COMPANIES

	IPO COMPANIES	ESTABLISHED PUBLIC COMPANIES	
		S&P 500	RUSSELL 3000
Classified board	83%	11%	42%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	83%	21% to 39%, depending on type of action	17% to 56%, depending on type of action
Prohibition of stockholders' right to act by written consent	86%	70%	74%
Limitation of stockholders' right to call special meetings	94%	35%	51%
Advance notice requirements	96%	97%	92%
Section 203 of the Delaware corporation statute (not opt out)*	73%	93%	82%
Blank check preferred stock	99%	95%	95%
Multi-class capital structure	14%	8%	10%
Exclusive forum provisions*	90%	43%	49%
Stockholder rights plan	None	1%	2%

\*Delaware corporations only

Source: IPO company data is based on WilmerHale analysis of SEC filings from 2015 to 2019 for US issuers. Established public company data is from FactSet's SharkRepellent database at year-end 2019.

of director nominations, provide important information about the experience and suitability of board candidates. These provisions could also have the effect of delaying until the next stockholders' meeting actions that are favored by the holders of a majority of the company's stock.

### STATE ANTI-TAKEOVER LAWS

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

Section 203 prevents a public company incorporated in Delaware (where more than 90% of all IPO companies are incorporated) from engaging in a "business combination" with any "interested stockholder" for three years following the time that the person became an interested stockholder, unless, among other exceptions, the interested stockholder attained such status with the approval of the board. A business combination includes, among other things, a merger or consolidation involving the interested

stockholder and the sale of more than 10% of the company's assets. In general, an interested stockholder is any stockholder that, together with its affiliates, beneficially owns 15% or more of the company's stock. A public company incorporated in Delaware is automatically subject to Section 203, unless it opts out in its original corporate charter or pursuant to a subsequent charter or bylaw amendment approved by stockholders. Remaining subject to Section 203 helps eliminate the ability of an insurgent to accumulate and/or exercise control without paying a control premium, but could prevent stockholders from accepting an attractive acquisition offer that is opposed by an entrenched board.

### BLANK CHECK PREFERRED STOCK

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

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

## DIFFERENCES IN ANTI-TAKEOVER PRACTICES AMONG TYPES OF IPO COMPANIES

	ALL IPO COMPANIES	VC-BACKED COMPANIES	PE-BACKED COMPANIES	OTHER IPO COMPANIES
Classified board	83%	92%	88%	55%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	83%	94%	86%	54%
Prohibition of stockholders' right to act by written consent	86%	96%	91%	60%
Limitation of stockholders' right to call special meetings	94%	98%	97%	82%
Advance notice requirements	96%	99%	99%	86%
Section 203 of the Delaware corporation statute (not opt out)*	73%	94%	25%	57%
Blank check preferred stock	99%	100%	100%	97%
Multi-class capital structure	14%	14%	12%	16%
Exclusive forum provisions*	90%	91%	92%	79%
Stockholder rights plan	None	None	None	None

\*Delaware corporations only  
Source: WilmerHale analysis of SEC filings from 2015 to 2019 for US issuers.

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

### MULTI-CLASS CAPITAL STRUCTURES

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

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

rights to every stockholder (a "one share, one vote" model), some companies go public with a multi-class capital structure under which some or all pre-IPO stockholders hold shares of common stock that are entitled to multiple votes per share, while the public is issued a separate class of common stock that is entitled to only one vote per share, or no voting rights at all. Use of a multi-class capital structure facilitates the ability of the holders of the high-vote stock to retain voting control over the company and to pursue strategies to maximize long-term stockholder value. Critics believe that a multi-class capital structure entrenches the holders of the high-vote stock, insulating them from takeover attempts and the will of public stockholders, and that the mismatch between voting power and economic interest may increase the possibility that the holders of the high-vote stock will pursue a riskier business strategy.

### EXCLUSIVE FORUM PROVISIONS

*Should the company's corporate charter or bylaws provide that the Court of Chancery*

*of the State of Delaware is the exclusive forum in which stockholders may bring state-law claims against the company and its directors?*

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

### STOCKHOLDER RIGHTS PLANS

*Should the company establish a poison pill?*

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



## 8 Antitrust Guidelines for Pre-Closing Activities

The Hart-Scott-Rodino Act (HSR Act) requires parties to a merger or acquisition meeting certain size thresholds—generally, at least \$94.0 million (as of February 27, 2020)—to report the transaction to the Federal Trade Commission (FTC) and the Department of Justice (DOJ) and to observe the prescribed waiting period. Observance of the HSR waiting period is a significant enforcement issue at both the FTC and the DOJ.

### ANTITRUST WAITING PERIOD

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

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

If the reviewing agency believes the transaction raises competitive concerns, or if more time is needed to investigate properly, the reviewing agency can extend the waiting period by issuing a “Second Request,” which typically involves the production of a substantial amount of additional documentation, information and economic analysis. A Second Request can also be

prompted by complaints from customers or competitors of the parties to the transaction. A Second Request can extend the waiting period for large transactions raising significant competitive issues by several months or more. In 2019, for example, the average review period for complex transactions was approximately one year.

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

### INTEGRATION PLANNING NEEDS

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

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

Restrictions on pre-closing activities can be frustrating to parties facing an extended HSR review or post-HSR period before closing. With proper guidance, however,

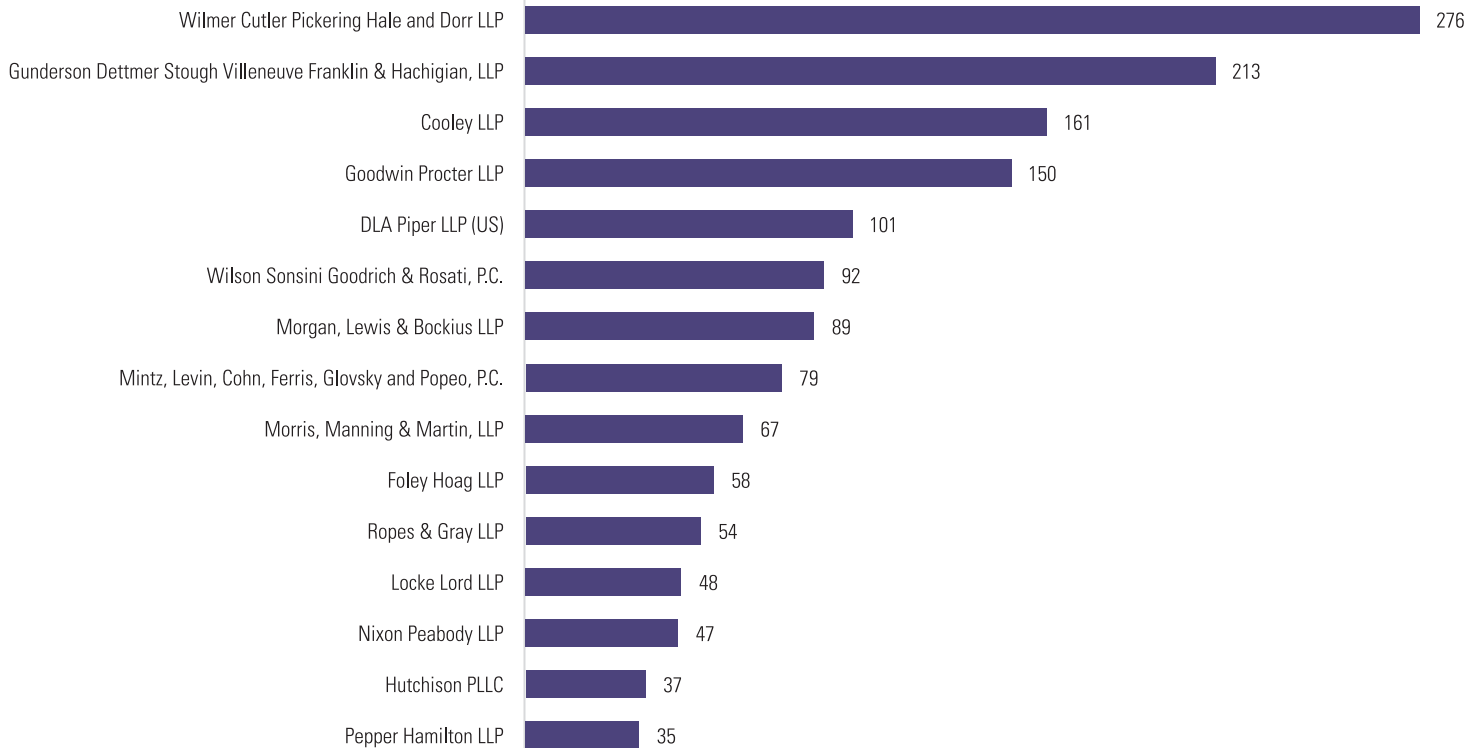
parties should be able to achieve most of their pre-closing goals without undue risk of gun-jumping violations. ■

### INTEGRATION DO’S AND DON’TS

Below are general guidelines to avoid alleged gun-jumping offenses that can result in antitrust violations and closing delays:

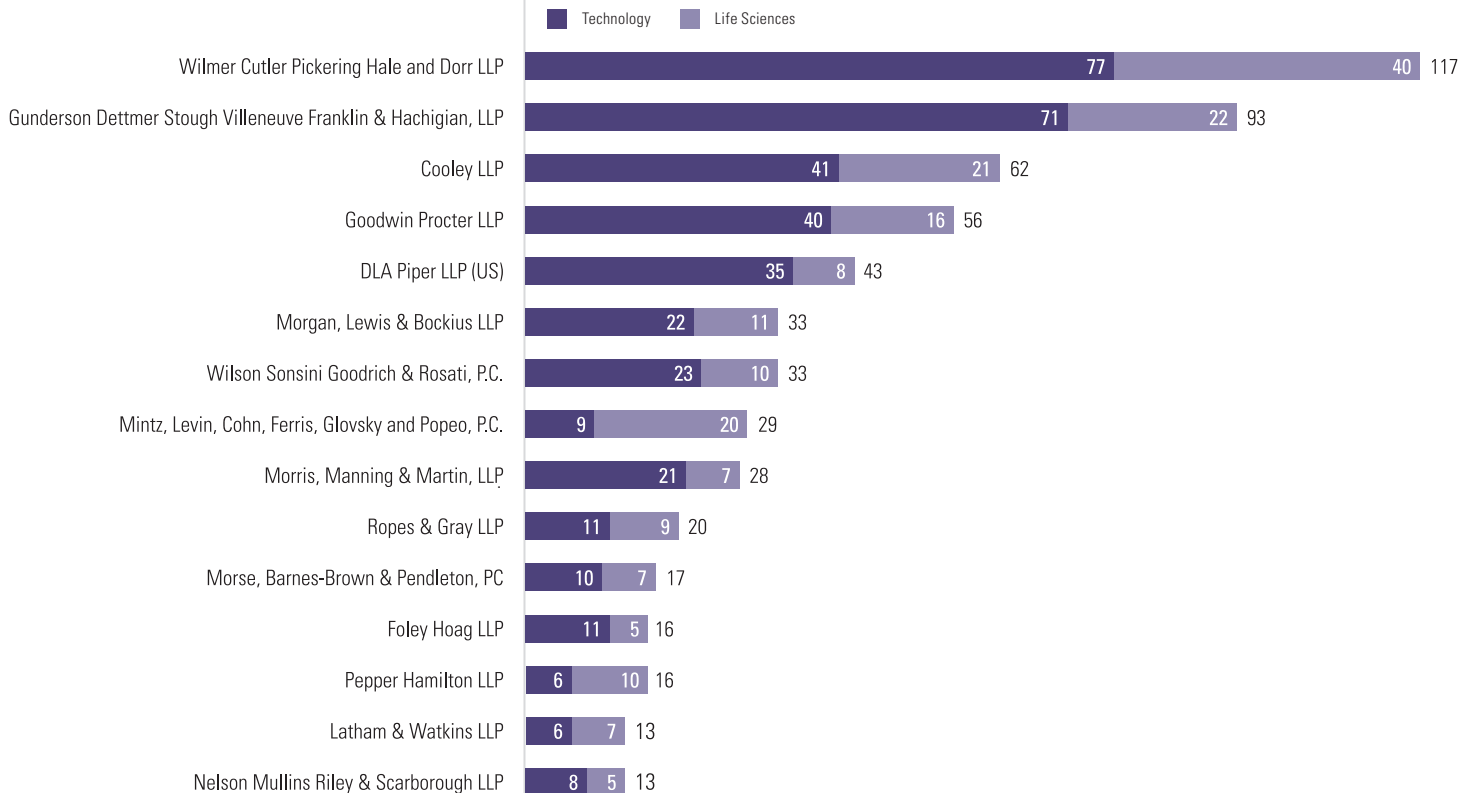
- **DO** share only information that is necessary for normal due diligence purposes and assessment of future integration. If pricing or other highly sensitive information must be shared, its dissemination should be limited to employees of the other party who need to know and who are not involved in setting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

**Counsel in Sales of Eastern US VC-Backed Companies – 1996 to 2019**



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 2019**










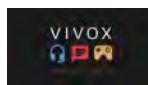
























The above chart is based on VC-backed information technology and life sciences companies located east of the Mississippi River.  
 Source: Dow Jones VentureSource

# Counsel of Choice for Mergers and Acquisitions

Serving industry leaders in technology, life sciences, cleantech, financial services, communications and beyond



 <p>Acquisition by Cisco Systems <b>\$2,600,000,000</b> Pending (as of May 31, 2020)</p>	 <p>Acquisition by Roku <b>\$150,000,000</b> November 2019</p>	 <p>Acquisition of Janrain <b>\$125,000,000</b> January 2019</p>	 <p>Acquisition by EG Group <b>Undisclosed</b> October 2019</p>	 <p>Acquisition by Astellas Pharma <b>\$405,000,000</b> (including contingent payments) December 2018</p>	 <p>Acquisition by Intercontinental Exchange <b>\$685,000,000</b> July 2018</p>	 <p>Acquisition of Electro Scientific Industries <b>\$1,000,000,000</b> February 2019</p>	 <p>Sale of anatomical pathology business to PHC Holdings <b>\$1,140,000,000</b> June 2019</p>	
 <p>Acquisition by Altaris Capital Partners <b>\$1,100,000,000</b> June 2018</p>	 <p>Acquisition by Unity Technologies <b>Undisclosed</b> January 2019</p>	 <p>Acquisition of Noventis <b>\$310,000,000</b> January 2019</p>	 <p>Acquisition of Prüftechnik Dieter Busch <b>Undisclosed</b> July 2019</p>	 <p>Acquisition of Syntron Material Handling Group <b>\$179,000,000</b> January 2019</p>	 <p>Acquisition of Ipswitch <b>\$225,000,000</b> April 2019</p>	 <p>Acquisition of Interface Performance Materials from Wind Point Partners <b>\$265,000,000</b> August 2018</p>	 <p>Acquisition by Dun &amp; Bradstreet <b>Undisclosed</b> July 2019</p>	 <p>Merger with Nanometrics to form Onto Innovation <b>\$1,400,000,000</b> (enterprise value) October 2019</p>
 <p>Acquisition by Microsoft <b>Undisclosed</b> April 2020</p>	 <p>Acquisition by Vertex Pharmaceuticals <b>\$1,000,000,000</b> (including contingent payments) July 2019</p>	 <p>Acquisition by Trimble <b>\$201,100,000</b> January 2020</p>	 <p>Acquisition of Rodin Therapeutics <b>\$950,000,000</b> (including contingent payments) November 2019</p>	 <p>Acquisition of Agilis Biotherapeutics <b>\$200,000,000</b> August 2018</p>	 <p>Sale of Riverside clinical and standardized testing business to Alpine Investors <b>\$140,000,000</b> October 2018</p>	 <p>Acquisition by Aon Group <b>Undisclosed</b> January 2020</p>	 <p>Merger with Sprint <b>\$26,500,000,000</b> April 2020 (regulatory counsel to T-Mobile)</p>	
 <p>Sale of SinglePlatform digital storefront business to TripAdvisor <b>\$51,000,000</b> December 2019</p>	 <p>Acquisition by X4 Pharmaceuticals <b>\$165,000,000</b> March 2019</p>	 <p>Acquisition of Digital Specialty Chemicals <b>\$64,500,000</b> March 2019</p>	 <p>Acquisition and disposition transactions involving Teem Technologies, Conductor, SpaceIQ, Prolific Interactive and Managed by Q <b>Undisclosed</b> Various dates 2019–2020</p>	 <p>Acquisition of Peak Resorts <b>\$264,000,000</b> September 2019</p>	 <p>Acquisition by Sandy Spring Bancorp <b>Undisclosed</b> January 2020</p>	 <p>Acquisition of Galileo Financial Technologies <b>\$1,200,000,000</b> May 2020</p>		

## 12 Disclosure Considerations in Private Company Mergers

US securities laws impose extensive disclosure requirements on the announcement, pendency and completion of public company mergers, and such transactions face a high probability of litigation challenging the adequacy of the disclosure. By contrast, the laws applicable to private company mergers have few express disclosure requirements, and litigation regarding the disclosure in such transactions remains relatively rare. For this reason, stockholder disclosure in private company mergers often receives less attention than in public company transactions.

The fact that stockholder disclosure in private company deals often occurs after the transaction has been approved (and, in some cases, consummated) can make disclosure seem like even more of an afterthought. However, not all disclosure obligations arise from specific statutory requirements. Any time a company communicates with its stockholders, those communications are subject to the fiduciary duties of the board of directors, and those duties can impose broad disclosure requirements that apply with equal force to public and private companies. Consequently, although private transactions are less likely to generate disclosure challenges, they are still susceptible to many of the same disclosure claims that have become ubiquitous in public deals.

In a typical private company merger, the target will arrange for a controlling group of stockholders to approve the transaction by written consent immediately after it is approved by the board and the merger agreement is executed. In this fact pattern, there are two statutory disclosure requirements: (1) the company must provide a notice under Section 228(e) of the Delaware General Corporation Law (DGCL) informing stockholders that did not vote on the transaction that the merger has been approved, and (2) the company must provide the appraisal rights notice required under Section 262 of the DGCL. In each case, the express disclosure requirements of the applicable statute are minimal. However, under both Section 228(e) and Section 262, the Delaware courts have imposed more expansive disclosure obligations through their interpretation of the fiduciary duties of the board of directors.

### DISCLOSURE UNDER SECTION 228(e)

Section 228 of the DGCL allows a corporation to obtain stockholder approval by written consent in lieu of a meeting, including for purposes of a strategic transaction such as a merger. Once that written consent has been obtained, Section 228(e) requires the corporation to notify the stockholders that did not consent to the approved actions, but says very little about the contents of the notice itself. The only substantive disclosure requirement in Section 228(e) is that “[p]rompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to those stockholders or members who have not consented in writing.” The statute says nothing about the requisite contents of the notice, and the Delaware courts have not specified the precise parameters of disclosure required by Section 228(e).

Nonetheless, whenever the board of directors communicates with a corporation’s stockholders, the board’s fiduciary duties require it to communicate honestly. When directors disclose that an action has been taken by written consent under Section 228, they have an obligation to provide the stockholders with an accurate, full and fair characterization of the events disclosed. This duty includes avoiding omissions that would make the disclosure materially misleading. In some cases, this may not translate into a significant burden.

In the case of minor housekeeping actions, for example, a Section 228(e) notice often consists of little more than the resolutions passed by the majority stockholders. In the case of a strategic transaction, however, more is generally required. The corporation should inform stockholders not only of the action taken, but also its practical effect. This includes any pricing associated with the transaction, the nature of the benefits associated with the transaction and the identity of the participants upon whom those benefits are bestowed (particularly if some participants, such as directors or management, receive benefits that are different than those conferred upon the common stockholders). The board of directors should ensure that the notice provides the minority stockholders with

the context necessary to understand the full consequences of the transaction.

### APPRAISAL DISCLOSURE UNDER SECTION 262

When a Delaware corporation is a party to a merger, its stockholders are entitled to appraisal rights under Section 262 of the DGCL, and the corporation must notify its stockholders of those rights. As with Section 228(e), the Delaware appraisal statute includes very few explicit disclosure requirements for the required notice. Section 262(d) requires only that:

- the corporation notify its stockholders that appraisal rights are available;
- a copy of the appraisal statute be included with such notice;
- if the merger or consolidation has been approved prior to such notice, the corporation notify its stockholders of such approval; and
- if the merger or consolidation has been consummated prior to such notice, the corporation notify its stockholders of the effective date of the merger or consolidation.

However, when the board requests stockholder action (rather than notifying them of an action that has already occurred), it has a heightened disclosure obligation under its fiduciary duties and must provide the stockholders with all material information within its control. The Delaware courts have concluded that an appraisal notice constitutes a request for action because it asks stockholders to make an investment decision of whether to accept the merger consideration or demand appraisal. As a result, the disclosure requirements associated with an appraisal notice are significantly broader than those arising with a notice required only by Section 228(e).

Materiality in this context is judged by a standard roughly equivalent to that used under US securities law. A fact is material if there is a substantial likelihood that a reasonable stockholder would consider the fact important in his or her decision-making process. An omitted fact is *not* material simply because it might be helpful. Instead, there must be a



substantial likelihood that the omitted fact would significantly alter the total mix of information provided. Numerous Delaware cases have interpreted this standard as it applies to various types of information.

Based on these cases, there are several categories of information that a target company should consider including in an appraisal notice (in addition to the information required with a Section 228(e) notice):

- **Merger Agreement:** A copy of the merger agreement approved by the board.
- **Instructions for Demanding Appraisal:** The instructions should be sufficient to enable a reasonable stockholder to perfect his or her appraisal rights.
- **Financial Statements:** Financial statements or comparable financial data are an important component of an appraisal notice. There is no bright-line rule for the periods required, but it is advisable to provide both current and historic financial information, to the extent available.
- **Description of the Company's Business and Prospects:** Providing a short description of the target's business is generally a straightforward exercise, but determining the nature and degree of the required disclosure regarding its prospects is less so. Numerous cases have considered whether the board's fiduciary duties require disclosure of financial projections and reached different results depending on the circumstances. Although the cases arguably do not reflect a consistent standard, it is probably safe to conclude that the board is not obligated to produce projections where none exist, or to disclose existing projections that it has reasonably determined are unreliable or stale. However, if projections were relied on by the board or its financial advisor, particularly for the purpose of performing a valuation analysis used by the board in evaluating the transaction, it is likely they will be considered material. This is particularly true if the projections were used in the analysis supporting a fairness opinion.
- **Background and Reasons:** The appraisal notice should include a description of

the board's decision-making process, often referred to as the "background" section, as well as the reasons why the board approved the transaction. In a public company transaction, the background section typically includes a detailed description of the negotiations and board deliberations leading up to the signing of the merger agreement. This description is usually less granular in private company disclosure documents, generally reflecting the absence of SEC requirements for private acquisitions and a less conservative approach to defensive disclosure given the significantly lower risk of litigation in private transactions.

- **Conflicts of Interest:** Conflicts of interest that could influence the decision making of directors and members of senior management will likely be deemed material. In addition, if the target engages a financial advisor (particularly if the board relies on the advisor's advice regarding valuation), disclosure of conflicts of interest involving the financial advisor may also be required. This often includes the amount and structure of the financial advisor's fee, especially if the amount is material and structured in a manner that incentivizes support for a transaction, as well as any material relationships between the financial advisor and other parties to the transaction.
- **Valuation Information:** In some circumstances, Delaware courts have concluded that the valuation methodology used to determine or evaluate the merger consideration should be disclosed. This may not be required if the acquisition price was determined through a bidding process without reference to a separate valuation assessment, but if the board obtains a fairness opinion from its financial advisor, that opinion and a summary of the underlying financial analyses (including key assumptions and implied valuation ranges) should be disclosed. In addition, if minority stockholders are being squeezed out by a majority holder in a short-form merger, the methodology used to determine the price paid to the minority will likely be deemed material.

Many of the cases elaborating on the materiality standard for fiduciary disclosure obligations involve a document that served as both a proxy statement and appraisal notice, and it is not always clear whether a standard is being articulated for appraisal disclosure specifically. While there may be circumstances where it is possible to argue that materiality should be judged differently from the perspective of a vote versus an appraisal decision, there are multiple cases suggesting that Delaware courts do not distinguish between these two contexts when assessing materiality.

Also, target companies often use the appraisal notice to continue soliciting stockholder consents either (1) to maximize the number of stockholders that waive appraisal rights (which may be necessary to reach a minimum threshold required under the merger agreement), or (2) to approve "golden parachute" compensation for the purpose of satisfying Section 280G of the Internal Revenue Code. This means an appraisal notice may still be soliciting stockholder votes, even though the requisite approval to consummate the transaction has already been obtained. Even if this is not the case, it is prudent to assume that materiality determinations in the context of proxy statements will generally apply to appraisal notices as well.

The fact that Delaware law does not distinguish between the fiduciary duties of boards of directors of public and private companies does not mean that private companies need to emulate the voluminous disclosure documents produced in public company transactions. Some of this disclosure is dictated by SEC requirements that do not apply to private transactions, and some is prophylactic to reduce the scope of disclosure claims in the lawsuits that are inevitable in public company transactions and frequently of dubious merit. However, disclosure claims are also brought in private transactions from time to time, and as private companies increasingly defer the decision to go public and become larger, the frequency of disclosure claims in private transactions may increase. Thus, it is important for those preparing disclosure in the context of a private company merger to remain mindful of the disclosure standards established in public company practice. ■



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

Public and private company M&A transactions share many characteristics, but also involve different rules and conventions. Described below are some of the ways in which acquisitions of public and private targets differ.

### GENERAL CONSIDERATIONS

The M&A process for public and private company acquisitions differs in several respects:

- **Structure:** An acquisition of a private company may be structured as an asset purchase, a stock purchase or a merger. A public company acquisition is generally structured as a merger, often in combination with a tender offer for all-cash acquisitions.
- **Letter of Intent:** If a public company is the target in an acquisition, there is usually no letter of intent. The parties typically go straight to a definitive agreement, due in part to concerns over creating a premature disclosure obligation. Sometimes an unsigned term sheet is also prepared.
- **Timetable:** The timetable before signing the definitive agreement is often more compressed in an acquisition of a public company. However, more time may be required between signing and closing to prepare and file disclosure documents with the SEC, comply with notice and timing requirements, and obtain antitrust clearances that may be unnecessary (or easier to obtain) in smaller, private company acquisitions.
- **Confidentiality:** The potential damage from a leak is much greater in an M&A transaction involving a public company, and accordingly rigorous confidentiality precautions are taken.
- **Director Liability:** The board of a public target will almost certainly obtain a fairness opinion from an investment banking firm and is much more likely to be challenged by litigation alleging a breach of fiduciary duties or the failure to disclose material information related to the transaction.

### DUE DILIGENCE

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

from the process followed in a private company acquisition:

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

### MERGER AGREEMENT

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

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

### SEC INVOLVEMENT

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

- **Form S-4:** In a public acquisition, if the acquirer is issuing stock to the target's stockholders, the acquirer must register the issuance on a Form S-4 registration statement that is filed with (and possibly reviewed by) the SEC.
- **Stockholder Approval:** Absent a tender offer, the target's stockholders, and sometimes the acquirer's stockholders, must approve the transaction. Stockholder approval is sought pursuant to a proxy statement that is filed with (and often reviewed by) the SEC. Public targets seeking stockholder approval generally must provide for a separate, non-binding stockholder vote with respect to all compensation each named executive officer will receive in the transaction.
- **Tender Offer Filings:** In a tender offer for a public target, the acquirer must file a Schedule TO and the target must file a Schedule 14D-9. The SEC staff reviews and often comments on these filings.
- **Public Communications:** Elaborate SEC regulations govern public communications by the parties in the period between the first public announcement of the transaction and the closing of the transaction.
- **Multiple SEC Filings:** Many Form 8-Ks and other SEC filings are often required by public companies that are party to M&A transactions.

Set forth on the following page is a comparison of selected deal terms in public target and private target acquisitions, based on the most recent studies available from SRS Acquiom (a provider of post-closing transaction management services) and the Mergers & Acquisitions Committee of the American Bar Association's Business Law Section. The SRS Acquiom study covers private target acquisitions in which it served as shareholder representative and that closed in 2019. The ABA private target study covers acquisitions that were completed in 2018 and the first quarter of 2019, and the ABA public target study covers acquisitions that were announced in 2016 (excluding acquisitions by private equity buyers).

## COMPARISON OF SELECTED DEAL TERMS

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

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

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

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

“10b-5” Representation	
PUBLIC (ABA)	1%
PRIVATE (ABA)	17%
PRIVATE (SRS ACQUIOM)	26%
Standard for Accuracy of Target Representations at Closing	
PUBLIC (ABA)	
“MAC/MAE”	99%
“In all material respects”	None
Other standard	1%
PRIVATE (ABA)	
“MAC/MAE”	67%
“In all material respects”	32%
“In all respects”	2%
PRIVATE (SRS ACQUIOM)	
“MAC/MAE”	48%
“In all material respects”	50%
“In all respects”	2%
Inclusion of “Prospects” in MAC/MAE Definition	
PUBLIC (ABA)	None
PRIVATE (ABA)	10%
PRIVATE (SRS ACQUIOM)	15%

Fiduciary Exception to “No-Shop/No-Talk” Covenant	
PUBLIC (ABA)	100%
PRIVATE (ABA)	4%
PRIVATE (SRS ACQUIOM)	3%
Opinion of Target’s Counsel as Closing Condition	
PUBLIC (ABA)	
	–
PRIVATE (ABA)	
	3%
PRIVATE (SRS ACQUIOM)	
	8%
Appraisal Rights Closing Condition	
PUBLIC (ABA)	
All cash deals	4%
Part cash/part stock deals	11%
PRIVATE (ABA)	
All deals	44%
PRIVATE (SRS ACQUIOM)	
All deals	57%
Acquirer MAC/MAE Closing Condition	
PUBLIC (ABA)	
	100%
PRIVATE (ABA)	
	97%
PRIVATE (SRS ACQUIOM)	
	97%

**TRENDS IN SELECTED DEAL TERMS**

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

**In transactions involving public company targets:**

- **“10b-5” Representations:** These representations, whose frequency had fallen steadily from a peak of 19% of acquisitions announced in 2004, were present in only 1% of acquisitions announced in 2016.
- **Accuracy of Target Representations at Closing:** The MAC/MAE standard remains almost universal, present in 99% of acquisitions announced in 2016 compared to 89% of acquisitions announced in 2004. In practice, this trend has been offset to some extent by the use of lower standards for specific representations, such as those relating to capitalization and authority.
- **Inclusion of “Prospects” in MAC/MAE Definition:** The target’s “prospects” were not included in the MAC/MAE definition in any acquisitions announced in 2016, representing a sharp decline from 10% of the acquisitions announced in 2004.
- **Fiduciary Exception to “No-Shop/No-Talk” Covenant:** The fiduciary exception in 97% of acquisitions announced in 2016 was based on the concept of “an acquisition proposal reasonably expected to result in a superior offer” (up from 79% in 2004), while the standard based on the mere existence of any “acquisition proposal” was present in 3% of acquisitions announced in 2016 (down from 10% in 2004). The standard based on an actual “superior offer” fell from 11% in 2004 to just 1% in 2016. In practice, these trends have been partly offset by an increase in “back-door” fiduciary exceptions, such as the “whenever fiduciary duties require” standard.
- **“Go-Shop” Provisions:** “Go-shop” provisions, granting the target a specified

period of time to seek a better deal after signing an acquisition agreement, appeared in 2% of acquisitions announced in 2016 (similar to the 3% of acquisitions announced in 2007, but down from 11% in 2013).

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

**In transactions involving private company targets:**

- **“10b-5” Representations:** The prevalence of these representations has declined from 59% of acquisitions completed in 2004 to 17% of acquisitions completed in 2018 and the first quarter of 2019.
- **Accuracy of Target Representations at Closing:** The MAC/MAE standard has gained much wider acceptance, appearing in 67% of acquisitions completed in 2018 and the first quarter of 2019, compared to 37% of acquisitions completed in 2004.
- **Inclusion of “Prospects” in MAC/MAE Definition:** The target’s “prospects” appeared in the MAC/MAE definition in 10% of acquisitions completed in 2018 and the first quarter of 2019, down from 36% of acquisitions completed in 2006.
- **Fiduciary Exception to “No-Shop/No-Talk” Covenant:** Fiduciary exceptions were present in only 4% of acquisitions completed in 2018 and the first quarter of 2019, compared to 25% of acquisitions completed in 2008.
- **Opinion of Target Counsel:** Legal opinions (excluding tax matters) of the target’s counsel have plummeted in frequency, from 73% of acquisitions completed in 2004 to just 3% of acquisitions completed in 2018 and the first quarter of 2019.
- **Appraisal Rights Closing Condition:** An appraisal rights closing condition was included in 44% of acquisitions completed in 2018 and the first quarter of 2019, down from 57% in 2008. ■

**POST-CLOSING CLAIMS**

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

- **Frequency of Claims:** 40% of all transactions had at least one post-closing indemnification claim (excluding purchase price adjustments) against the escrow. Claim frequency increased with transaction value, from 28% of deals valued at \$50 million or less, to 55% of deals valued in excess of \$500 million. Claims were most likely in deals with financial buyers (49% of transactions) and least likely in deals with US private buyers or foreign buyers (37% of transactions in each case).
- **Size of Claims:** Median claim size (excluding purchase price adjustments) as a percentage of the escrow ranged from a high of 127% for fraud claims to a low of 1% for capitalization claims. On average, claim size as a percentage of the escrow was highest on deals valued at \$50 million or less and on deals with financial buyers, and lowest on deals valued in excess of \$200 million and on deals with US public buyers.
- **Subject Matter of Claims:** Among all claims, the subject matter consisted of breaches of representations and warranties (49%), purchase price adjustments (28%), transaction fees/costs (20%), appraisal rights (1%) and fraud (1%).
- **Bases for Misrepresentation Claims:** Most frequently claimed misrepresentations involved tax (45%), capitalization (12%), employee-related (11%), undisclosed liabilities (9%), intellectual property (8%), financial statements (7%), regulatory compliance (3%) and customer contracts (3%).
- **Resolution of Claims:** Contested claims were resolved in a median of 2.1 months. Regulatory claims took the most time to be resolved (median of 13 months), while fraud claims were resolved the quickest (median of one month).
- **Purchase Price Adjustments:** 82.5% of all transactions had mechanisms for purchase price adjustments. Of these, 74% had a post-closing adjustment (favorable to the buyer in 42% of transactions and favorable to target stockholders in 32% of transactions).
- **Expense Fund:** Median size of \$200,000 (0.24% of transaction value).



Buyers or sellers of companies can purchase representation and warranty insurance (R&W insurance) to provide coverage for indemnification claims arising from the seller's misrepresentations. The use of R&W insurance has grown in recent years, particularly in sales of privately held companies backed by venture capital or private equity investors. As with other forms of insurance, R&W insurance policies have deductibles, coverage limits, exclusions and policy periods. Premiums typically range from 2% to 4% of the coverage limit.

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

Below is a summary of the principal effects on transaction terms when buy-side R&W insurance is present, based on an analysis conducted by SRS Acquiom of 642 private-target acquisitions that closed from 2016 through 2018, in which SRS Acquiom provided professional and financial services. In its study, called the *2019 Buy-Side Representations and Warranties Insurance (RWI) Deal Terms Study*, SRS Acquiom noted that the reported effects of buy-side R&W insurance on deal terms are likely understated due to data limitations.

## DEAL CHARACTERISTICS

- Buy-side R&W insurance is more common in larger deals. In the study's sample, the median size of transactions with buy-side R&W insurance was \$135 million, compared to \$60 million in other transactions.
- Among deals involving publicly held buyers, the less leverage the buyer has relative to the seller (measured by the ratio of the buyer's market capitalization to the transaction value), the higher the probability that the buyer will purchase R&W insurance.

## FINANCIAL TERMS

- Indemnification escrows are significantly smaller (or eliminated entirely) when buy-side R&W insurance is

present, with a median size of just 1%, compared to 10% in other deals.

- Deals with buy-side R&W insurance are more likely than other deals to contain a purchase price adjustment mechanism (by a margin of 95% to 74%), with a strong preference to rely on a separate escrow to secure the purchase price adjustment (79% of deals with buy-side R&W insurance, compared to 34% of other deals).

## REPRESENTATIONS AND WARRANTIES

- A "10b-5" or "full disclosure" representation—to the effect that the seller's representations and warranties are complete, accurate and not misleading—is absent from 91% of deals with buy-side R&W insurance, compared to 61% of other deals. Similarly, provisions to the effect that the seller is making no representations except as set forth in the acquisition agreement are more likely to be present in deals with buy-side R&W insurance than other deals (by a margin of 94% to 68%).
- "Pro-sandbagging" (or "benefit of the bargain") provisions, allowing a party to seek indemnification for the other party's misrepresentations even if the non-breaching party knew of the misrepresentations prior to closing, are present in 29% of deals involving buy-side R&W insurance, compared to 59% of other deals.
- "Materiality scrapes" appear in 96% of deals with buy-side R&W insurance and 87% of other deals, but deals with buy-side R&W insurance are twice as likely to provide that materiality qualifications in representations and warranties are disregarded for purposes of determining both breaches and damages.
- The acquisition agreement is less likely to require the seller to notify the buyer of pre-closing breaches of representations and warranties when buy-side R&W insurance is present (56%) than in other deals (80%).
- In deals with buy-side R&W insurance, the forward-looking language in the definition of material adverse change/

effect is the seller-favorable "would be" formulation in 85% of deals and the "could be" formulation in 13% of deals. Among other deals, 71% use the "would be" formulation and 18% use the "could be" formulation.

## LOSS MITIGATION AND SETOFFS

- When buy-side R&W insurance is present, the acquisition agreement is more likely than in other deals to require the buyer to mitigate losses (by a margin of 75% to 49%) and offset losses against any recovery from insurance (by a margin of 90% to 86%) or tax benefits (by a margin of 46% to 31%).
- Among deals with earnouts, 59% involving buy-side R&W insurance expressly permit buyers to offset indemnification claims against future earnout payments, compared to 83% of other deals, and 27% of deals with buy-side R&W insurance expressly prohibit such offsets, compared to only 3% of other deals.
- In deals with buy-side R&W insurance, the seller's indemnification obligations are more likely to be structured as a "deductible basket," in which the seller is liable only for damages in excess of a specified threshold amount (75% of deals), than a "tipping basket," in which the seller is liable for all damages once the threshold amount has been reached (13% of deals). By contrast, in other deals, the seller's indemnification obligations are structured as a "deductible basket" in 41% of deals and as a "tipping basket" in 54% of deals.

## DISPUTE RESOLUTION

- A conflict waiver provision allowing the sell-side law firm to represent the seller post-closing is present in 86% of deals with buy-side R&W insurance, compared to 56% of other deals.
- The parties specify an alternative dispute resolution mechanism in only 13% of deals with buy-side R&W insurance, compared to 28% of other deals.
- The parties waive jury trials in 95% of deals involving buy-side R&W insurance, compared to 74% of other deals. ■

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

We reviewed all merger transactions between 2012 and 2019 involving venture-backed targets (as reported in either Dow Jones VentureSource or Pitchbook for 2019 or in Dow Jones VentureSource for years prior to 2019) 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:<sup>1</sup>

Characteristics of Deals Reviewed		2012	2013	2014	2015	2016	2017	2018	2019
The number of deals we reviewed and the type of consideration paid in each	Sample Size	26	27	37	27	19	18	37	20
	Cash	73%	59%	59%	67%	53%	56%	84%	60%
	Stock	8%	11%	6%	4%	0%	0%	3%	0%
	Cash and Stock	19%	30%	35%	29%	47%	44%	13%	40%
Deals with Earnout		2012	2013	2014	2015	2016	2017	2018	2019
Deals that provided contingent consideration based upon post-closing performance of the target (other than balance sheet adjustments)	With Earnout	31%	33%	30%	26%	37%	22%	32%	40%
	Without Earnout	69%	67%	70%	74%	63%	78%	68%	60%
Deals with Indemnification		2012	2013	2014	2015	2016	2017	2018	2019
Deals where the target's shareholders or the buyer indemnified the other post-closing for breaches of representations, warranties and covenants	With Indemnification								
	By Target's Shareholders	100%	100%	97%	100%	100% <sup>2</sup>	94% <sup>3</sup>	84%	80%
	By Buyer	62%	44%	49%	69%	37%	61%	39%	45%
Survival of Representations and Warranties		2012	2013	2014	2015	2016	2017	2018	2019
Length of time that representations and warranties survived the closing for indemnification purposes (subset: deals where representations and warranties survived the closing for indemnification purposes) <sup>4</sup>	Shortest	10 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.	9 Mos.	12 Mos.	12 Mos.
	Longest	24 Mos.	30 Mos.	24 Mos.	24 Mos.	18 Mos.	24 Mos.	24 Mos.	24 Mos.
	Most Frequent	18 Mos.	18 Mos.	12 & 18 Mos. (tie)	18 Mos.	18 Mos.	12 Mos.	18 Mos.	18 Mos.
Caps on Indemnification Obligations		2012	2013	2014	2015	2016	2017	2018	2019
Upper limits on indemnification obligations where representations and warranties survived the closing for indemnification purposes	With Cap	100%	100%	100%	100%	100%	100%	100%	100%
	Limited to Escrow	81%	88%	89%	79%	83%	94% <sup>6</sup>	79%	86%
	Limited to Purchase Price	0%	0%	0%	0%	0%	0%	0%	0%
	Exceptions to Limits <sup>5</sup>	96%	100%	100%	100%	95%	94%	100%	100%
	Without Cap	0%	0%	0%	0%	0%	0%	0%	0%

<sup>1</sup> For certain transactions, certain deal terms have been redacted from the publicly available documentation and are not reflected in the data compiled below.

<sup>2</sup> Includes one transaction where the only representations that survive for purposes of indemnification are certain "fundamental" representations and representations concerning material contracts and intellectual property.

<sup>3</sup> Includes one transaction where the only representations that survive for purposes of indemnification are those concerning capitalization, financial statements and undisclosed liabilities, but excludes one transaction where indemnification was provided for breaches of covenants prior to the closing but representations did not survive for purposes of indemnification.

<sup>4</sup> Measured for representations and warranties generally; specified representations and warranties may survive longer.

<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.

<sup>6</sup> Includes two transactions where the limit was below the escrow amount.



# Trends in VC-Backed Company M&A Deal Terms 19

Escrows		2012	2013	2014	2015	2016	2017	2018	2019
Deals having escrows securing indemnification obligations of the target's shareholders (subset: deals with indemnification obligations of the target shareholders)	With Escrow	100%	93% <sup>7</sup>	100%	93%	89%	100%	90% <sup>7</sup>	94%
	% of Deal Value								
	Lowest <sup>8</sup>	5%	5%	2%	4%	5%	4%	3%	10%
	Highest	16%	20%	16%	16%	15%	13%	15%	13%
	Most Frequent	10%	10%	10%	10%	10%	5%	10%	12%
	Length of Time <sup>9</sup>								
	Shortest	10 Mos.	12 Mos.	12 Mos.	12 Mos.	12 Mos.	9 Mos.	12 Mos.	12 Mos.
	Longest	48 Mos.	30 Mos.	24 Mos.	36 Mos.	24 Mos.	24 Mos.	36 Mos.	36 Mos.
	Most Frequent	12 Mos.	18 Mos.	12 Mos.	12 & 18 Mos. (tie)	18 Mos.	12 & 18 Mos. (tie)	18 Mos.	12 Mos.
	Exclusive Remedy	73%	60%	86%	63%	88%	71%	72%	64%
Exceptions to Escrow Limit Where Escrow Was Exclusive Remedy <sup>5</sup>	100%	100%	100%	100%	93%	92%	100%	100%	
Baskets for Indemnification		2012	2013	2014	2015	2016	2017	2018	2019
Deals with indemnification only for amounts above a specified "deductible" or only after a specified "threshold" amount is reached	Deductible <sup>10</sup>	27%	50%	44%	31%	47%	63%	47%	56%
	Threshold <sup>10</sup>	65%	42%	56%	61%	53%	37%	53%	44%
MAE Closing Condition		2012	2013	2014	2015	2016	2017	2018	2019
Deals with closing condition for the absence of a "material adverse effect" with respect to the other party, either explicitly or through representation brought down to closing	Condition in Favor of Buyer	95%	100%	97%	100%	100%	94%	100%	100%
	Condition in Favor of Target	9%	17%	19%	12%	39%	22%	12%	35%
Exceptions to MAE		2012	2013	2014	2015	2016	2017	2018	2019
Deals where the definition of "material adverse effect" for the target contained specified exceptions	With Exception <sup>11</sup>	84% <sup>12</sup>	96% <sup>13</sup>	100%	100%	100%	100%	97% <sup>13</sup>	100%

<sup>7</sup> One transaction not including an escrow at closing did require funding of escrow with proceeds of earnout payments.

<sup>8</sup> Excludes transactions which also specifically referred to representation and warranty insurance as recourse for the buyer.

<sup>9</sup> Length of time does not include transactions where such time period cannot be ascertained from publicly available documentation.

<sup>10</sup> A "hybrid" approach with both a deductible and a threshold was used in another 8% of these transactions in 2012, 8% of these transactions in 2013, and 8% of these transactions in 2015.

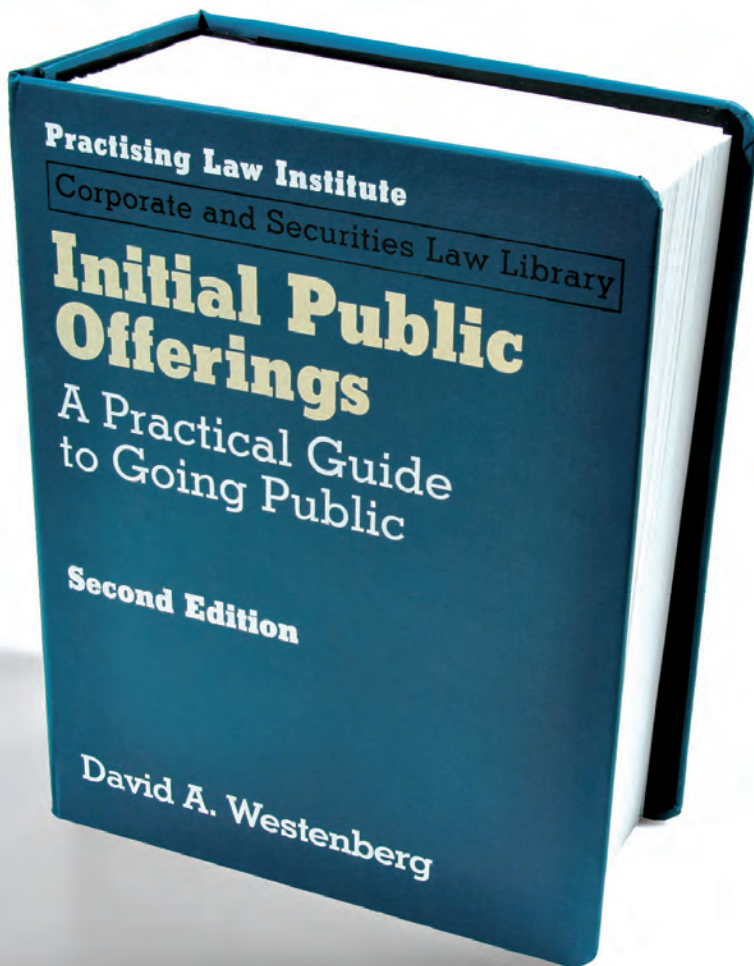
<sup>11</sup> Generally, exceptions were for general economic and industry conditions.

<sup>12</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>13</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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