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2018 Trends in M&A: Diligence, Drafting, Deal Certainty and Integration

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Illustrative Transaction Timeline

Phase	Actions
Due Diligence	▪ Parties negotiate and enter into confidentiality agreement and letter of intent/exclusivity agreement, if applicable ▪ Parties engage legal and financial advisors ▪ Seller prepares data room and conducts sell-side due diligence ▪ Buyer conducts due diligence on target, including attendance of management sessions ▪ Parties agree on material terms of the transaction (e.g.; purchase price)
Definitive Documentation	▪ Buyer or seller prepares initial draft purchase agreement and shares with other party ▪ Parties negotiate transaction documents ▪ Parties obtain any necessary internal approvals ▪ Execution of transaction documents and announcement of transaction
Between Signing and Closing	▪ Parties seek any required regulatory approvals ▪ Parties seek any required shareholder approvals ▪ Parties seek to satisfy all other closing conditions ▪ Seller conducts the business in accordance with interim operating covenants ▪ Buyer finalizes financing arrangements ▪ Parties prepare funds flow ▪ Parties prepare closing documentation
Closing	▪ Buyer wires funds to sellers or exchange agent (in merger context) ▪ Parties exchange closing documents
Post-Closing	▪ Parties determine and settle any post-closing adjustment payments ▪ Commencement and resolution of any indemnification claims or other disputes ▪ Finalize appraisal proceedings ▪ Parties finalize purchase price distribution process with exchange agent (in merger context) ▪ Buyer undertakes integration process

Due Diligence – General

There has recently been heightened focus on several areas of due diligence, including:

- Data privacy and Cybersecurity
- Intellectual Property
- FCPA/Anti Corruption
- Material Contracts

Due Diligence – Data Privacy and Cybersecurity

- Recent high-profile data breaches at companies like Yahoo, Equifax, Target, Anthem and Uber have highlighted the risks associated with data security
- In 2016 alone, there were over 1,000 data breaches costing American companies more than $100 billion, according to the Identity Theft Resource Center
- Data breaches subject companies to significant liability arising from:
  - Shareholder lawsuits
  - Government Investigations
  - Remediation Costs
  - Reputational Damage

Due Diligence – Data Privacy and Cybersecurity (cont'd)

- Buyers should diligence closely the data privacy and cybersecurity processes and procedures of a target, including with respect to:
  - Identifying key data sets in the possession of the target
  - Identifying any data privacy regulations to which the target is subject (*e.g.*; HIPAA, GLBA, FCRA, state privacy regulations, EU regulations)
  - Evaluating actual compliance with applicable regulations and internal controls implemented to ensure compliance
  - Reviewing data collection notices and evaluate target's compliance with representations made in such notices (*e.g.*; limitations on use, sale or disclosure)
  - Analyzing any prior or ongoing data privacy breaches and response tactics
  - Evaluating data privacy insurance coverage
  - Is the target compliant with the new EU General Data Protection Regulation (GDPR)?
    - Comprehensive overhaul of EU data privacy regulations, with increasingly strict requirements and harsh penalties
  - Does the target have appropriate safeguards in place with third party vendors?

Due Diligence – Intellectual Property

- Conduct a worldwide search to determine if company owns any registered IP, including:
  - Patents
  - Trademarks
  - Copyrights
  - Domain Names
- Many companies do not apply for registered IP rights with respect to its software, instead opting to keep the software a trade secret
  - Review all employment and third party independent contractor agreements to make sure they include proper confidentiality and invention assignment provisions
  - In certain cases, conduct a freedom to operate (FTO) analysis to identify and analyze patent claims having the closest claim scope to that of the software at issue
- Review inbound and outbound license agreements for use of open source programs, scope of licenses, ability to transfer the license in the agreement; *etc*.
  - Review for whether company has combined open source with proprietary software in a way that requires the software to be made publicly available under the open source license
  - Obtain and review Construx Report to evaluate third party code
- Evaluate prior or pending IP Litigation
- Confirm that Software and related IT Systems:
  - are bug free
  - have not had any material security breaches
  - have not had any material outages affecting business

Due Diligence – FCPA/Anti-Corruption

Buyers should assess the target's FCPA/anti-corruption risk profile by evaluating the following:

- The industry in which the target operates
- The markets where the target does business
- The target's interactions with government officials and charities
- The target's relationships with third parties
- The target's reputation

Areas of focus for conducting due diligence should include:

- Review of FCPA compliance policy and other internal controls associated with FCPA, including appropriate training
- Interviews with key employees
- Review of past or pending violations or inquiries and remediation thereof
- Analysis of certain payments
- Self-reporting

Due Diligence – FCPA/Anti-Corruption (cont'd)

The SEC and DOJ have issued joint guidance highlighting the benefits of conducting robust FCPA due diligence in the M&A context:

- Buyers are able to better evaluate target's value
- Buyers are able to negotiate deal terms that protect the buyer from bearing the costs of pre-closing non-compliance
- Buyers can identify issues, assess risks and ensure their remediation prior to the closing or immediately following closing
- DOJ and SEC may be more lenient to buyers in the event a thorough due diligence review is conducted by the buyer and the buyer demonstrates a commitment to compliance by:
    - integrating a target into its compliance function immediately following the transaction;
    - self-reporting any non-compliance identified;
    - cooperating with the investigation;
    - conducting further post-closing due diligence where pre-closing due diligence is not possible.

Due Diligence – Material Contracts

A thorough review of material contracts is critical to identify, among other things:

- any third party consents required by the transaction
- financial rights and obligations
- contractual liabilities or indemnities that may be assumed in the transaction
- restrictive covenants or other obligations to which the target is subject and whether the buyer or its current affiliates may become subject to such obligations
- applicable termination rights of either party

Due Diligence – Material Contracts (cont'd)

The following is a checklist of the types of provisions buyers should review in conducting due diligence of material contracts:

- Dataroom Number
- Name of Agreement
- Revenue Generated
- Date (and Effective Date if different)
- Parties
- Subject Matter/Scope of Agreement
- Term
- Renewal Provisions
- Expiration Date
- Terminable at Will
- Other Termination Provisions
- License/Sublicense Provisions

- Other IP Provisions
- Change of Control
- Assignment
- Financial Terms
- Non-Compete Provisions (specify if the covenant applies to affiliates)
- Non-Solicitation of Employees/No Raid (specify if the covenant applies to affiliates)
- Exclusivity/Most Favored Nation Provisions (specify if the covenant applies to affiliates)
- Minimum Purchase Commitments
- Right of First Offer/Right of First Refusal, *etc.*

- Other Restrictive Covenants (specify if the covenant applies to affiliates)
- Data Security Provisions
- Representations and Warranties
- Indemnification
- Limitation on Liability
- Employee-Related Provisions
- Insurance Provisions
- Applicable Law
- Dispute Forum
- Affirmative Action Government Hiring Procedures
- Other Noteworthy Provisions

Due Diligence – Practical Considerations

In-house counsel may be faced with certain challenges in coordinating legal due diligence

- Effect of time pressure on quality and duration of process
- Managing business leader expectations
- Form of work product
- Understanding of primary business objectives
- Coordination of various internal specialists (many of whom have “day jobs”)
- Managing outside counsel
- Sharing of competitively sensitive information

Conflicts of Interest – Banker Conflicts

- Boards should take care to vet financial advisors for potential conflicts of interest early in the process
  - Implement procedures to ensure that any conflicts that arise are disclosed
  - Consider reputational risk in addition to potential financial exposure
- Disclose, Disclose, Disclose
  - Disclosure and waivers in engagement letters
  - Fees and other relationships with other transaction participants
  - Financial advisor and its employees may have short or long positions in parties' stock
  - Consider financial advisor's desire to obtain work from counterparties
  - Efforts to provide buy-side financing
- Mitigate risks of conflicts - Second "independent advisors"; strong, independent fairness committees and unbiased valuations; firewalls; recusal from certain discussions
- Key Decisions
  - *In re Del Monte Foods Company S'holders Litig.*
  - *In re El Paso Corporation S'holder Litig.*
  - *In Re Rural Metro Corporation Stockholder Litigation, C.A.*

Conflicts of Interest – Banker Conflicts – Bad Facts

	Del Monte	*El Paso*	*Rural/Metro*
Unauthorized Start of Sale Process	X		X
Unauthorized Efforts to Obtain Buyside Financing Role	X		X
Behind the Scenes Dealings with Bidders	X		X
Marketing Only to Financial Buyers	X	X	X
Conflicted Advisor Ran Process for Alternative Transactions	X	X	X
Financial Advisor's Investment in Bidder		X	

Conflicts of Interest – Board and Management Conflicts

- In-house counsel are often called upon to help navigate management and board conflicts with respect to M&A transactions, including with respect to the following:
  - Continued employment of key management with purchaser
  - Equity rollover of certain stockholders
  - Conflicted board members
  - Controlling stockholders
- This has been highlighted in recent transactions involving Tesla/SolarCity, Fuji/Xerox and CBS/Viacom

Conflicts of Interest – *Fuji/Xerox* Case Study

Fuji/Xerox

- Fuji initiated discussions with Xerox regarding a potential acquisition of Xerox.
  - Xerox informed Fuji that it would only enter discussions if Fuji's offer reflected an appropriate control premium and provided 100% cash consideration.
- Xerox CEO was later informed that both Carl Icahn and the Board wanted to replace him.
- The Board told CEO to desist from further discussions with Fuji regarding the potential acquisition.
- CEO continued negotiations in violation of Board instructions.
- Fuji and CEO had a number of discussions making clear that CEO's continued employment would be a condition to the deal.
- Fuji made a proposal to Xerox and financial advisor urged the Board to consider whether it was beneficial enough to Xerox and whether other alternative opportunities were available.
- Certain Xerox directors expressed initial resistance to the proposal, one calling Xerox CEO a "rogue executive" for continuing negotiations with Fuji.
- Despite earlier resistance, the Board unanimously approved the proposed acquisition:
  - Granted Fuji a 50.1% controlling interest in Xerox.
  - Xerox would issue a $2.5 billion dividend to shareholders.
  - Xerox CEO would become CEO of combined company.
  - 5 of 10 existing Xerox directors (in addition to Xerox CEO who was also a director) would become directors of combined company.

Conflicts of Interest – *Fuji/Xerox* Case Study (cont'd)

Fuji/Xerox

- **The court granted a motion to preliminarily enjoin the proposed transaction, finding it likely that the Xerox Board breached its fiduciary duties:**
  - The transaction was "largely negotiated by a massively conflicted CEO in breach of his fiduciary duties to further his self-interest and approved by a Board, more than half of whom were perpetuating themselves in office for five years without properly supervising Xerox's conflicted CEO."
  - The "lynchpin" of the decision was CEO's conduct and the Board's "acquiescence."
    - CEO pushed for approval of a proposal before annual meeting, despite lack of any "exigent necessity" to do so.
    - No effort to explore feasible alternative transactions.
    - CEO structured a "one sided" transaction in order to maintain his position at the expense of Xerox shareholders.
    - The Board approved the transaction despite knowledge of conflicts and earlier criticism of the proposal and CEO's conduct in negotiating it.
- **Fuji also found likely to have aided and abetted the Xerox Board in breach of fiduciary duties:**
  - Fuji CEO wrote that the transaction "enabled Fuji to take control of Xerox without spending a penny," knowing it disproportionately favored Fuji.
  - Fuji knew CEO was conflicted and used it to their advantage.

  In Re Xerox Corporation Consolidated Shareholder Litigation, No. 650766/18, 2018 WL 2054280 (N.Y. Sup. Ct. Apr. 27, 2018).

Conflicts of Interest – *Tesla/SolarCity* Case Study

Tesla / SolarCity

- Plaintiffs alleged that Tesla's board and Elon Musk breached their fiduciary duties by approving a $2.6 billion acquisition of SolarCity, which benefitted SolarCity stockholders to the detriment of Tesla stockholders.
- Plaintiffs argued that entire fairness review should apply because Elon Musk was the controlling stockholder.
  - At the time of the transaction, Mr. Musk owned approximately 22.1% of Tesla's stock and was Chairman of the Tesla Board, Chief Executive Officer of Tesla and Chief Product Architect of Tesla.
  - No special committee was formed and no majority of the minority vote was sought.
- Defendants argued that Mr. Musk was not a controlling stockholder and therefore should be given business judgment deference.
- The Court found that "it is reasonably conceivable that Musk, as a controlling stockholder, controlled the Tesla Board in connection with the Acquisition" because:
  - Mr. Musk's 22% ownership is significant and a stockholder owning less than a majority of outstanding shares may nonetheless be a controlling stockholder;
  - of circumstantial evidence, including the weak financial state of SolarCity at the time of Tesla's offer and ultimate agreement to acquire the company, the persistence with which Mr. Musk proposed the transaction to the Tesla board and the lack of consideration of alternative transactions;
  - Mr. Musk was the face of Tesla and his past behavior of ousting the prior CEO and providing financial support for the company in hard times, as well as his current status at Tesla, may have impacted the board's decision-making process;
  - a majority of the other board members that voted on the transaction may not have been independent with respect to the transaction, making it less likely that they would resist Mr. Musk's proposals; and
  - the company and Mr. Musk had made past public statements implying Mr. Musk's control of, and importance to, the company.
- The decision is the latest in a line of cases in which Delaware courts have found that minority stockholders can, in certain circumstances, exercise corporate control.

In re Tesla Motors, Inc. Shareholder Litigation, C.A. No. 17211-VCS, slip op. (Del. Ch. Mar. 28, 2018)

Between Signing and Closing

What Can Result in an Elongated Period Between Signing and Closing?

- Transactions that are subject to numerous antitrust/regulatory approvals are generally more at risk of elongated periods between signing and closing
  - HSR
  - CFIUS
  - EC
  - China (MOFCOM, SAFE AND NDRC)
  - Industry-specific regulations
  - Others
- Required shareholder approvals may also cause an extended post-signing period
- Recent examples are transactions involving AT&T/Time Warner and Anthem/Cigna

Between Signing and Closing – Regulatory

What Can Be Done to Mitigate Regulatory Risks?

- Explicit and detailed "Efforts" clause, including expansive duty to defend against challenges and accept remedies
  - Important that all necessary counterparties are contractually bound
- Disposition Requirements
  - Hell-or-high-water covenant
  - Dollar threshold on requirement to undertake remedial actions
  - Unquantified qualitative thresholds
  - May not always be feasible – *e.g.*, CFIUS; vertical antitrust issue
- Length of termination date and/or right to extend
- Existence and size of reverse break fee
- Obligation of the parties to close if all approvals except those in nonmaterial jurisdictions have been received

Between Signing and Closing – Conduct of Business Covenants

Managing interim covenants during elongated review periods may present challenges as a result of unforeseen circumstances

- Negotiate more detailed and complex interim covenants
- Make sure senior management focuses on covenants and potential period in effect
- Require Acquiror's consent not to be unreasonably withheld, delayed or conditioned
  - Specify a reasonableness standard explicitly referencing need to take into account Target's commercial needs as a standalone company with no assurance that deal will close?
  - For some covenants specify that consent can only be withheld if proposed action would constitute MAE?
- Provide that the "compliance with covenants" closing condition and termination right to be subject to an MAE standard?
- Consider
  - Expedited proceedings as to dispute over consent denial
  - Liquidated damage for improper consent denial

Between Signing and Closing – Other Issues

- Other issues that may arise as a result of elongated review periods are:
  - Employee retention plans should be considered to ensure the employees of each party do not leave
  - Purchase price adjustment targets should take into account that closing may not occur for elongated period and that timing for closing may be difficult to predict
  - Business is locked up for long period and parties take market risk that the value of the company will differ at closing from what it was at signing

Appraisal – Current Statute

Stockholders have the right to seek a judicial determination of the "fair value" of their shares in certain transactions. 8 *Del. C.* § 262.

- Appraisal rights are afforded to:
  - Holders of unlisted stock held by under 2,000 holders of record.
  - Holders of listed stock (or stock held by more than 2,000 holders of record) if they are required to accept anything other than: (i) stock of the surviving corporation; (ii) shares of stock of another corporation listed on a national securities exchange or held by more than 2,000 holders of record; (iii) cash in lieu of fractional shares; or (iv) any combination thereof.
  - Holders if total number of share selling appraisal must exceed 1% of outstanding shares or $1 million based on deal price.
- Appraisal rights require stockholders to:
  - Deliver a written demand prior to the vote;
  - Abstain from voting on the merger or vote against it;
  - Continuously hold the stock through closing; and
  - Perfect appraisal rights after closing by filing a petition in the Court of Chancery.
- Stockholders are entitled to 5% statutory interest
  - Company may prepay to cut off this interest obligation

Recent court decisions have made the appraisal rights remedy less attractive to stockholders

Appraisal – Reliance on Deal Price – *DFC Global*

DFC Global Corp. v. Muirfield Value Partners, L.P., (Del. Aug. 1, 2017).

- The Delaware Supreme Court reversed the Court of Chancery's decision to give one third equal weight to its DCF, comparable companies analysis, and the merger price in determining the fair value of DFC.
- The Delaware Supreme Court strongly endorsed reliance on the deal price in cases involving an arm's-length transaction and a "robust" sales process.

Appraisal – Reliance on Deal Price – *Dell*

Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd, (Del. Dec. 14, 2017).

- The Court reaffirmed its holding in DFC that the deal price will generally be entitled to "heavy, if not dispositive, weight" in determining the fair value of a public company that was sold pursuant to an open, competitive, and arm's-length bidding process.
  - Extends this holding to situations where the pre-signing bidding process was relatively limited so long as the process was competitive and did not exclude logical potential bidders.
  - Also extends to MBOs so long as management is not a controlling stockholder and does not foreclose the idea of accepting other offers.
- The Court held that Delaware has "long endorsed" the "efficient market hypothesis" which "teaches that the price produced by an efficient market is generally a more reliable assessment of fair value than the view of a single analyst, especially an expert witness who caters her valuation to the litigation imperatives of a well-heeled client."

Appraisal – Below Deal Price – *Aruba*

Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., (Del. Ch. Feb. 15, 2018).

- The Court of Chancery found that the most persuasive evidence of fair value was the company's 30-day unaffected market price.
- Deal the result of an arm's-length transaction involving a publicly traded company without a controlling stockholder.
- Deal price contained synergies and a control premium (each of which are required to be backed out for appraisal purposes), and thus "logically exceeded fair value."
- Petitioner failed to identify a bidder who would pay a higher price, and thus lack of competition cuts against the petitioner.
- Court also unpersuaded by argument that Aruba's financial advisors were conflicted by attempting to leverage transaction to gain more work from the buyer.
- "… When underlying market price is reliable, competition and negotiation become secondary… [t]he issue in an appraisal is not whether a negotiator has extracted the highest possible bid. Rather, the key inquiry is whether the dissenters got fair value and were not exploited."

Appraisal – Below Deal Price – *AOL*

In re Appraisal of AOL, Inc., (Del. Ch. Feb. 23, 2018).

- While no presumption as to deal price, it should be considered "first among equals."
- The Court determined that the deal was not "*Dell* Compliant," and thus engaged in a DCF to determine fair value. A deal is "*Dell* Compliant" where:
  1. Information was sufficiently disseminated to potential bidders, so that
  2. An informed sale could take place,
  3. Without undue impediments imposed by the deal structure itself.

Arguments in favor of Dell-Compliance

- Stock was traded frequently
- Well-covered by analyst
- Widely known to be in play (despite no auction)
- Approached other logical buyers
- No prohibitive break up fee
- Good process

Arguments against Dell-Compliance

- No shop provision
- 3-day matching right
- Informational advantage for buyer due to lengthy data room access
- AOL president's public statement that it is committed to doing deal with Verizon signaled to other bidders that they need not make an offer

Appraisal – Current State of Play

Prior to Recent Cases

- Appraisal had become increasingly popular, including as a specific investment strategy
- This is because certain plaintiffs had success in recovering amounts in excess of the deal price and a plaintiff was entitled to a generous 5% statutory interest
- As a result, transaction participants sought to mitigate the risk of appraisal through:
  - Appraisal conditions
  - Holding consideration back to account for potential additional payments
  - A stronger focus on process

Impact of Recent Cases

- Lack of clarity as to how the court's will decide on appraisal cases; unpredictability of outcomes
- Potential for recovery of amounts below the deal price may have a chilling effect on appraisal claims
- May see less appraisal conditions in purchase agreements
- May result in more "bumpitrage" if stockholders don't believe they can rely on appraisal to increase consideration
- Ability to prepay and cut-off statutory interest makes appraisal less attractive

R&W Insurance – General

- Representations and Warranties insurance ("R&W Insurance") is designed to:
  - protect the policyholder (usually the buyer) from losses resulting from breaches of representations and warranties contained in a purchase agreement for the sale or acquisition of a business; and
  - substantially reduce the seller's indemnification obligations.
- In a typical transaction, the seller indemnifies the buyer for losses resulting from breaches of representations and warranties, subject to highly negotiated caps, deductibles, baskets and limitations. The seller will often agree that a portion of the purchase price will be held in escrow or be payable by the seller following the closing to satisfy the seller's indemnification obligations.
- In a transaction with R&W Insurance, the portion of the purchase price held in escrow or payable by the seller post-closing will be dramatically reduced and the primary recourse of the buyer will be directly against the insurer, as opposed to the seller.

R&W Insurance – Potential Issues

R&W Insurance may present certain issues that will require attention throughout the deal process:

- Increases complexity and resources required to be dedicated to the process
- Treatment of coverage gaps (exclusions, fundamental reps, known issues, etc.)
- Payment of premium and responsibility for deductible
- May create a "moral hazard" due to seller's minimal exposure to the reps

R&W Insurance – The Process

1. Contact a broker or insurer.
2. The broker or insurer will typically provide a price and coverage quote within a few days of being contacted.
3. Formally engage an insurer and start the underwriting due diligence process by signing an underwriting expense agreement.
4. Complete underwriting due diligence.
5. Buyer to review the policy and its coverage, compare the policy to the purchase agreement, and evaluate the costs and benefits of obtaining the policy.
6. The R&W Insurance policy will be bound concurrent with the signing of the purchase agreement and become effective as of the closing.

R&W Insurance – Liability Structure

- *Example – assume:*
  - $100 million deal
  - 10% cap ($10 million) [1]
  - 1.0% deductible and retention ($1 million) [2]

WITHOUT INSURANCE	WITH INSURANCE
$100,000,000 borne by buyer, according to the negotiated agreement	**$100,000,000** borne by buyer, according to the negotiated agreement
$10,000,000 borne by seller, through indemnification	**$10,000,000** borne by insurer, under R&W Insurance
$1,000,000 borne by buyer, through indemnification deductible	**$500,000*** borne by seller, through indemnification under agreement
	$500,000* borne by buyer, through indemnification deductible

[1] Under the 2017 SRS Deal Terms Study, the average cap was 13.2% and the median cap was 10.2% for transactions conducted in 2016. Under the 2015 ABA Deal Terms Study, the average cap was 13.2% and the median cap was 10% for transactions conducted in 2014.

[2] Under the 2015 SRS Deal Terms Study, the average deductible was 1.21% and the median deductible was 0.75% for transactions conducted in 2016. Under the 2017 ABA Deal Terms Study, the average deductible was 0.69% and the median deductible was 0.5% for transactions conducted between 2010 and 2012.

* Assumes 50/50 split of retention amount

** Reps excluded from the R&W insurance will likely be subject to a seller indemnity as set forth under "Without Insurance."

R&W Insurance – Advantages and Disadvantages from the Perspective of the Seller

ADVANTAGES

- Significantly lower indemnification exposure for the seller for breaches of representations.
- Shifts potential liability for unintentional and unknown breaches of representations and warranties from the seller to the insurer for a fixed cost (subject to a negotiated deductible and cap).
- The buyer will often pay the full premium in a competitive bidding situation.
- Should simplify and streamline negotiations of indemnity provisions.
- Shorter survival period and less exposure for breaches of fundamental representations if the policy is the buyer's sole recourse for these liabilities in excess of the deductible.

DISADVANTAGES

- Exclusions from coverage that arise during the underwriting process may cause the buyer to:
  - attempt to re-negotiate the agreement to use R&W insurance;
  - negotiate separate indemnity coverage for the excluded items; or
  - evaluate the target company's existing primary insurance coverage with respect to the excluded items (ability to rollover insurance policies may depend on the structure of the transaction).
- The buyer will not receive coverage on known events that occur after signing and before closing – which may cause the buyer to request that seller provide indemnification for this interim period.
- The buyer may pressure the seller to agree to a lower indemnification deductible on the basis that the seller has limited its exposure through the policy.
- The buyer may pressure the seller to agree to a double materiality scrape and an expanded definition of "losses" in the transaction agreement to ensure their inclusion in the insurance policy. These are generally highly negotiated points and agreement to these terms by the seller will increase the risk that the indemnification deductible amount is reached.
- They buyer may ask the seller to cover all or a portion of the premium cost.

R&W Insurance – Advantages and Disadvantages from the Perspective of the Buyer

ADVANTAGES

- Relatively low premiums (routinely between 2% to 4% of coverage limit).
  - Allows the buyer to recover directly against the insurer without making a claim against the seller.
  - Insurers are generally stable, credit-worthy entities.
- Limits interference with any post-closing relationship between the buyer and seller.
- The seller will often agree to broader representations and warranties.
- Policies generally offer a double materiality scrape if included in the transaction agreement.
- Policies may offer recovery for consequential, special and/or damages based on multiples of earnings and lost profits if the transaction agreement does not expressly include them as part of the loss definition.
- Policies generally offer a longer survival period for general reps (typically 6 years).
- Should simplify and streamline negotiations of indemnity provisions.

DISADVANTAGES

- R&W insurers are hesitant to insure against certain types of "risky" liabilities regardless of a known exposure, such as those related to IP, environmental and certain "at-risk" jurisdictions (such as China).
- R&W policies may contain other exclusions from coverage, which may only surface during the underwriting process, such as:
  - issues identified in the buyer's dude diligence process; and
  - those subject to insufficient due diligence by the buyer.
- Shorter survival period for fundamental reps (typically 6 years).
- Does not cover purchase price adjustments, earnouts or other contingent payment obligations under the transaction agreement.
- Fundamental reps are subject to deductible and cap under the insurance policy; any coverage of these "gaps" will need to be agreed to by the parties.
- R&W insurers will require that the closing occur within 120 days of the signing – later closings may be uninsurable, introduce new underwriting exclusions or require higher premium cost.
- May present "moral hazard" that seller does not provide full disclosure of potential issues.

Post-Closing – Integration

Once an M&A transaction is completed, in-house counsel are often called upon to assist with integration of the new business into the existing business

- Culture
- Contracts
- Operations
- Systems and Technology
- Legal/Compliance
- Employee Integration
- Data Management
- Other

Post-Closing – Extra Contractual Fraud Claims

- When other avenues of post-closing recovery are not available, buyer's may seek recovery from seller's based on extra-contractual fraud claims (*e.g.*; seller provided fraudulent financial statements to the buyer in due diligence)
- Whether such a fraud claim is available to a buyer will depend heavily on the language in the contract. The relevant provisions are generally:
  - Buyer acknowledgement of non-reliance on any representations other than those in the agreement
  - Seller disclaimer of any other representations
  - Integration Clause
- Delaware courts have ruled that anti-reliance provisions in purchase agreements may bar a buyer's ability to bring an extra-contractual fraud claim because "reliance" is an essential factor for determining fraud:
  - **No "Magic Words."** No "magic words" are required to bar extra-contractual fraud claims. For example, the Court enforced a non-reliance provision, coupled with an integration clause (reciting that the contract is the sole agreement between the parties and replaces any prior agreements), where the buyer acknowledged that the seller made no extrinsic representations, but did not specifically disclaim the buyer's reliance.
  - **"Positive Framing" is Permissible**. A non-reliance provision need not be framed in the negative, *e.g.*, buyer "did not rely" on any outside statements; rather, it may affirmatively state that the buyer relied solely on the representations in the contract.
  - **Must Not Solely Be from the Seller's Perspective**. An anti-reliance provision, whether specific or general, is not effective if it is drafted solely "from the point of view" of the seller rather than the buyer.
- Other states, such as California, have deemed such extra-contractual fraud waivers to be void and unenforceable

Recent relevant case law includes: Abry Partners V, L.P. v. F & W Acquisition LLC (2006), Anvil Holding Corp. v. Iron Acquisition Co. (2013), TrueBlue, Inc. v. Leeds Equity Partners IV, LP (2015), Prairie Capital III, L.P. v. Double E Holding Corp. (2015), FdG Logistics LLC v. A&R Logistics Holdings, Inc. (2016), IAC Search, LLC v. Conversant LLC (2016) and Sparton v. O'Neil (2018)

Post-Closing – The *Cigna* Case – Impact on Indemnification and Letters of Transmittal

Cigna v. Audax **(Cigna Health and Life Insurance Co. v. Audax Health Solutions Inc., C.A. No. 9405 (Del. Ch. Nov. 26, 2014))**

- In *Cigna*, the Court ruled that the buyer was unable to enforce certain provisions against the non-consenting selling stockholders
  - Invalidated an attempt to force stockholder to sign a letter of transmittal containing a release in exchange for the merger consideration because the requirement for a release was not included in the Merger Agreement and no additional consideration was provided in exchange therefor
  - Invalidated an indefinite and uncapped (up to the purchase price) indemnification obligation of a non-consenting stockholder for fundamental representations because under this construct a stockholder could not ascertain the consideration to be received in the merger
- As a result of this decision, buyers have negotiated extra protections in merger agreements, including by:
  - Agreeing on a form of letter of transmittal in the merger agreement containing customary releases and other provisions that a buyer expects a stockholder to agree to in exchange for the merger consideration
  - Agreeing on a form of joinder requiring each consenting stockholder to agree to be bound by the terms of the merger agreement applicable to stockholders
  - Including closing conditions requiring a certain specified amount of stockholders to execute a joinder to be bound by the terms of the merger agreement applicable to stockholders
  - Requiring consenting stockholders to bear responsibility for 100% of the indemnification obligations in excess of any escrow amount
  - Agreeing to indemnifications with capped amounts and limited durations