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## A Seller's Market Recent Trends in Mergers & Acquisitions

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Presented by Ernest Wechsler

Kramer Levin Naftalis & Frankel LLP

## It's a Seller's Market

- ❑ Significant increase in demand for target companies
- ❑ Fueled by private equity funds/cheap financing
- ❑ Acquisitions more frequently subject to auctions
- ❑ Significant shift in balance of power
- ❑ Case Law on M & A and fiduciary obligations
- ❑ Reflected in pricing and contract terms

## Areas That Have Been Impacted

- ❑ The initial mark-up
- ❑ Indemnity - caps, thresholds, escrows and survival
- ❑ Conditions to closing
- ❑ Definition of Material Adverse Effect
- ❑ Extent of representations and warranties
- ❑ No-shop provisions
- ❑ How are buyers coping?

## Indemnification Provisions - Caps

- ▣ Principal risk allocation provision
- ▣ Biggest shift has been the cap
- ▣ Vast majority of deals had cap at or below 15%
- ▣ Low single digits above 50%
- ▣ Market simply won't bear higher caps
- ▣ Buyers don't really need them

## Indemnification Provisions (cont'd) - Escrows

- ❑ Escrows - credit support/encourage “reasonableness”
- ❑ In past, high cap was joined with an escrow
- ❑ Now escrows often exclusive remedy
- ❑ Sole remedy in one-third of the deals
- ❑ Follow size of the cap
- ❑ Also often find no escrows at all
- ❑ No recourse in one-quarter of the deals

## Indemnification Provisions - Deductibles and Thresholds

- ❑ The threshold or deductible hotly contested
- ❑ Seller shielded from nonmaterial claims
- ❑ Two issues are size and nature
- ❑ Deductibles typically below 1% of price
- ❑ Thresholds range from 1% to 2%
- ❑ Deductibles somewhat more prevalent

## Indemnification Provisions – Trigger to Indemnity

- ❑ What is trigger to the indemnity provision
- ❑ Reps and warranties not true
- ❑ Main job was avoiding double materiality
- ❑ MAE can be high threshold
- ❑ New twist is to write out all materiality
- ❑ Deductible / threshold as materiality standard

# Indemnification Provisions - Survival

- ▣ Periods have generally shortened
- ▣ Vast majority at 12 to 18 months
- ▣ Rationale often to pass one audit cycle
- ▣ Carve-outs typical for
  - Employee Benefits
  - Environmental
  - Taxes
  - Authority
  - Capitalization
  - Title to shares / assets
- ▣ Carve-outs are hotly negotiated / more often dropped



# Conditions to Closing

- ❑ Two part signing and closing requires bring-down of reps
- ❑ What is “standard of truth”
- ❑ Choices
  - True in all respects
  - True in all material respects
  - True except where failure to be true reflects MAE
- ❑ Avoid double-materiality
- ❑ MAE standard is currently most common
- ❑ Given recent case law, very favorable to Seller
- ❑ Buyers and Sellers struggling with this provision

# Material Adverse Effect – How Bad Does it Have to Get

- ▣ Biggest Development is Tyson
- ▣ Significant and sustained deterioration
- ▣ Temporary deterioration is not sufficient
- ▣ Has created tension in closing conditions / indemnity triggers
- ▣ Exceptions have been expanding
  - general economic conditions has been standard
  - industry conditions added
  - disproportionately effects
  - announcement/pendency of deal
  - changes in political conditions / terrorism
  - changes in law
  - changes in accounting

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## Representations and Warranties

- ❑ Materiality within the reps can be less important
- ❑ No undisclosed liabilities
- ❑ Depends what you mean by liability
- ❑ Seller wants it defined by GAAP
- ❑ Buyer wants any liabilities
- ❑ Generally not limited by GAAP, but tie is going to the Seller

## Representations and Warranties (cont'd)

- ❑ Full disclosure (10b-5) Rep
- ❑ Concept taken from securities laws
- ❑ More onerous here if no knowledge requirement
- ❑ Approximately 50% of deals include 10b-5 Rep
- ❑ Who's knowledge is knowledge?

# Public Company Deals

- ❑ Always seller friendly – indemnity doesn't survive
- ❑ Provides context for reduced protection in private deals
- ❑ Difference is scrutiny of reporting company
- ❑ Closing conditions present similar challenges
  - high threshold for MAE
  - not moving from this standard
- ❑ Public companies face greater risks on failed deal

## Public Company Deals (cont'd)

- ▣ Auctions or at least vigorous market check
- ▣ Revlon duty requires obtaining highest price reasonably available
- ▣ Standard for reasonable process informed by market trends
- ▣ Recent case suggest new standards:
  - For certain sized companies, auction a must
  - Pursue strategic as well as financial buyers

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## Public Company Deals (cont'd)

- ❑ Market standard allows window shopping
- ❑ No solicitation of potential offers
- ❑ Ability to respond to unsolicited bids
- ❑ Bid must have ability to lead to superior offer
- ❑ Contrasts ability to respond only to superior offer
- ❑ Bidder needs to know how to open the door
- ❑ Buyer typically has ability to match

## Public Company Deals (cont'd)

- ❑ Most recent invention is the go-shop
- ❑ Company permitted to solicit higher bids
- ❑ Enables company to sign without market check
- ❑ Requires company to do post-signing market check
- ❑ Often used with private equity buyers



## How Buyers are Coping

- ❑ More extensive due diligence
- ❑ Doesn't shift the risk – “Zeh Ma'yesh”
- ❑ Often engage industry experts as consultants
- ❑ Identify more particular areas of concern
- ❑ Enables more surgical mark-up
- ❑ Significant challenge due to speed of deals

## How Buyers are Coping (cont'd)

- ❑ Increased use of representations and warranties insurance
- ❑ Neither Buyer nor Seller willing to bear risk
- ❑ Can be purchased by Buyer or Seller
- ❑ Insurance shifts the risk to insurer
- ❑ Enables parties to reduce/eliminate escrow and/or lower cap
- ❑ Breach must be unknown to insured

## How Buyers are Coping (cont'd)

- ❑ Policy can apply to all or some representations
- ❑ Duration - may match survival, not required
- ❑ Premium typically 3-7% of insured amount
- ❑ Buyer or Seller usually retains stipulated amount
- ❑ Modest indemnity as first source, then policy
- ❑ Can be particularly helpful in competitive bidding

## Conclusion

- ❑ Seller's market leads to Seller friendly agreements
- ❑ Ignoring the reality doesn't seem to help
- ❑ Greater emphasis on ensuring rights that do exist
- ❑ Pay attention to the drafting – even more



THANK YOU!

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