

Deal Point Considerations in Venture Backed M&A

Presented by the Private Equity and Venture Capital Committee

Panelists:

Jessica Pearlman

Joseph Conahan

Sayre Stevick

Glenn West

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Assessing the risk of stockholder claims

- Claims are far less prevalent in mergers involving VC-backed companies compared to mergers involving public company targets, **but you can't ignore the risk**
- Two main avenues:
 - Breach of fiduciary duties
 - Appraisal claims
- Need to consider and assess factors that might heighten risk:
 - Shareholder base and conflicts
 - Board composition and conflicts
 - Anticipated allocation of merger proceed among preferred and common stockholders and others (including management)
 - Trajectory of target's business (on the upswing?)

Mitigating the risk of stockholder claims

- Process
 - Develop a process designed to obtain the highest price reasonably available
- Record
 - Document process
 - Document board considerations
 - Consider viability of target's business in the absence of a transaction
 - Document rationale for management carve-out plans and consideration of impact on common stockholders
 - Consider overall fairness to common stockholders
 - Consider obtaining a fairness opinion (often not practical)

Mitigating the risk of stockholder claims

- Conflicts:
 - Consider creating an independent board committee
- Closing conditions:
 - Common stockholder approval closing condition
 - Dissenting share closing condition
- Drag-along rights:
 - Consider exercising drag-along rights to force approval and waiver of appraisal rights
 - But see *Halpin v. Riverstone*
- Indemnification:
 - Consider a special escrow



VC-BACKED COMPANY M&A DEAL TERMS

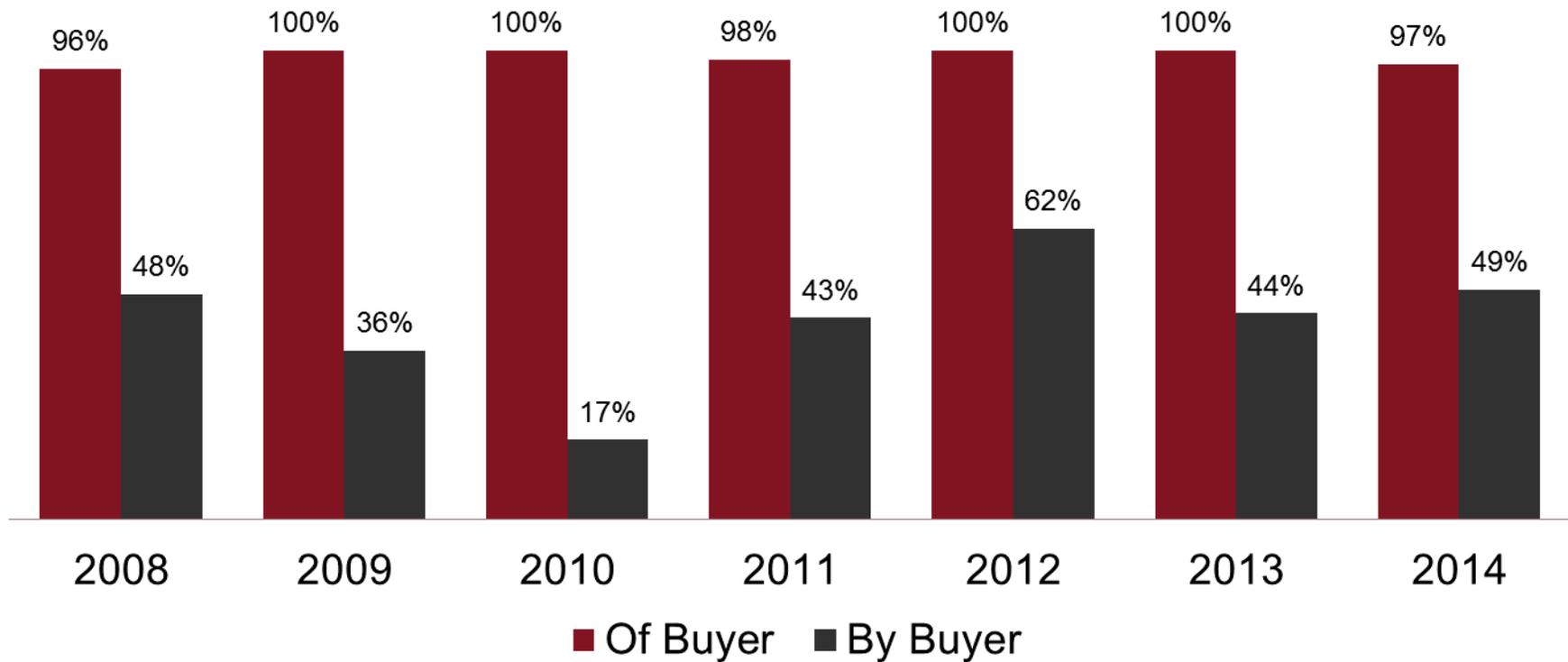
An Overview of
WilmerHale's 2015 Study

April 18, 2015

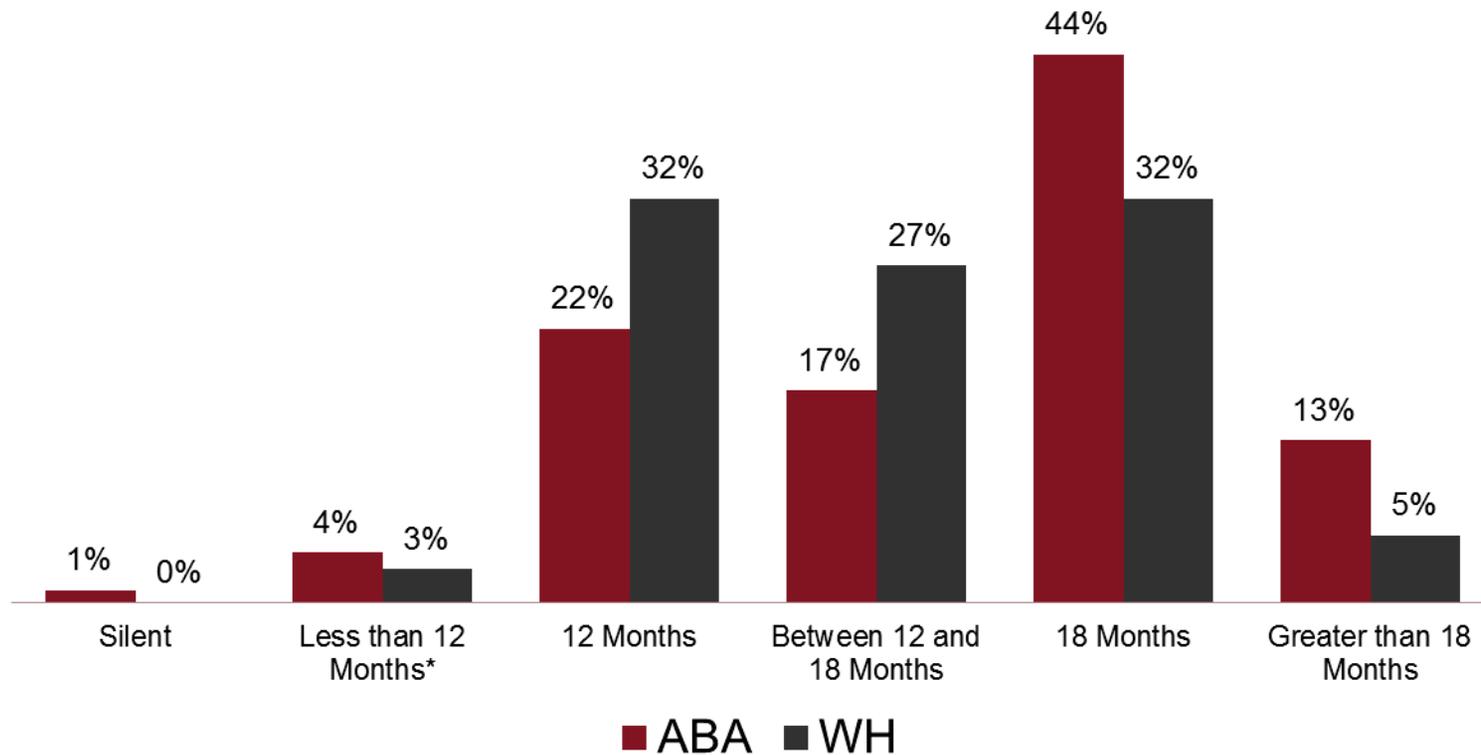
Study Parameters

- 2013 ABA Private Target Study:
 - Analyzes publicly available acquisition agreements for transactions completed in 2012 that involved private targets being acquired by public companies
 - Covers 136 deals, with transaction values ranging from \$17.2 million to \$4.7 billion
- 2015 WilmerHale VC-Backed Company Survey:
 - Analyzes publicly available acquisition agreements for transactions completed in 2014 that involved venture-backed targets (as reported in VentureSource) with a transaction value of at least \$25 million
 - Covers 37 deals, with transaction values ranging from \$26 million to \$4.0 billion

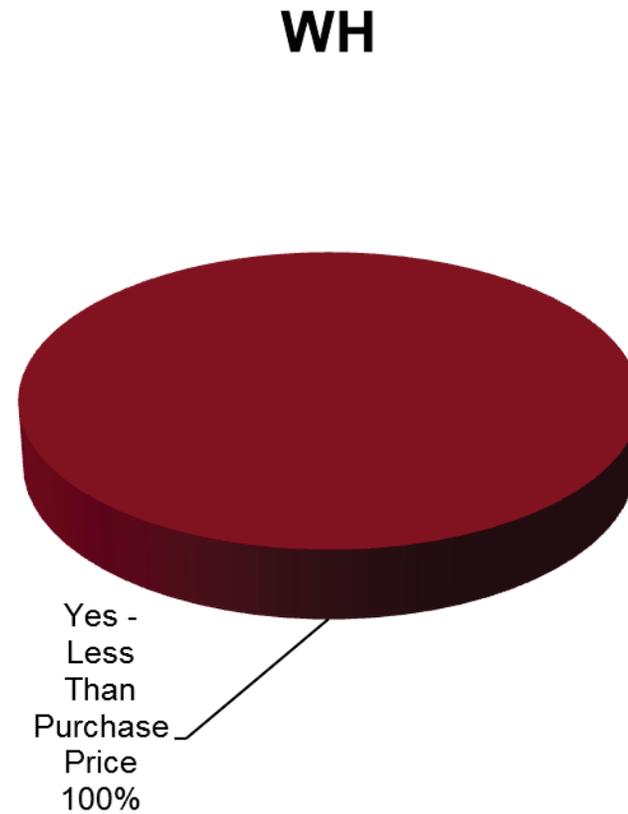
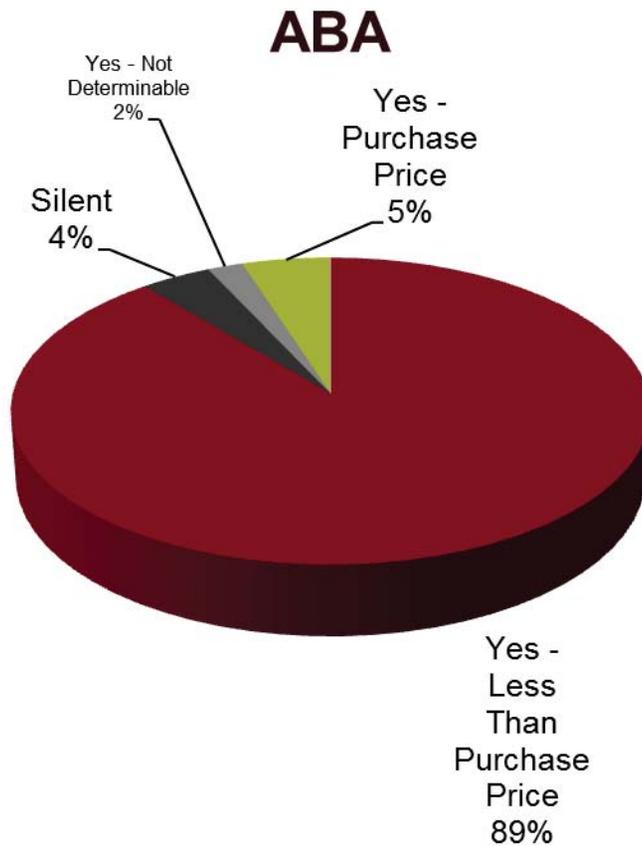
% of VC-Backed Deals with Indemnification (WH Study)



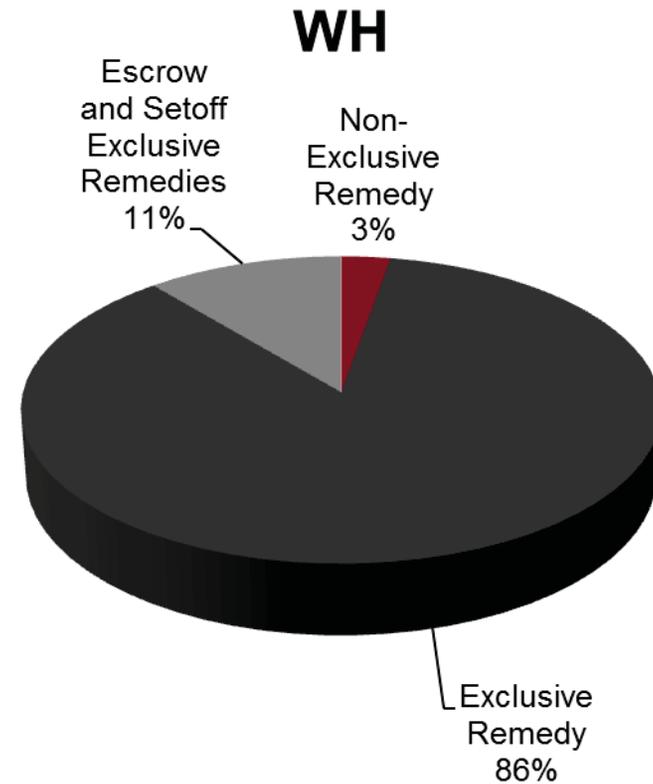
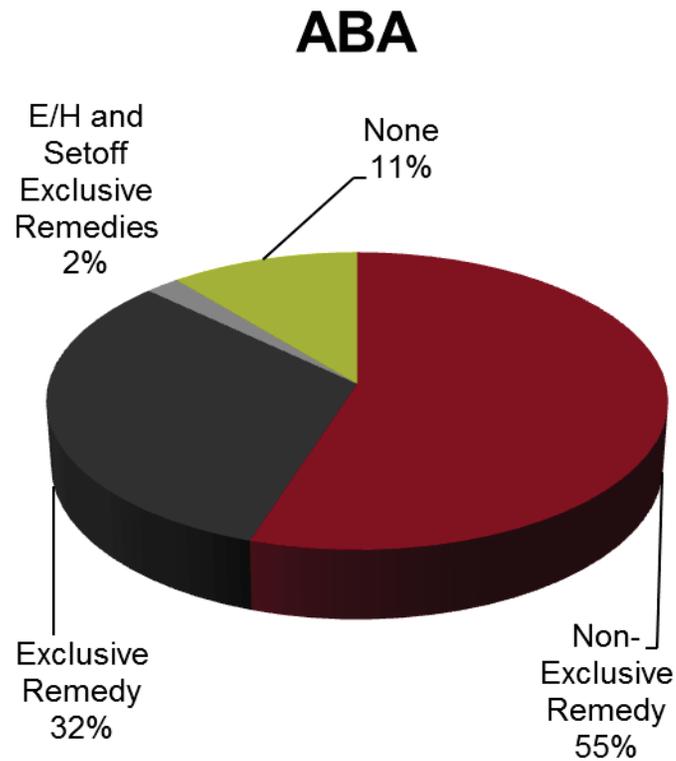
General Survival Periods



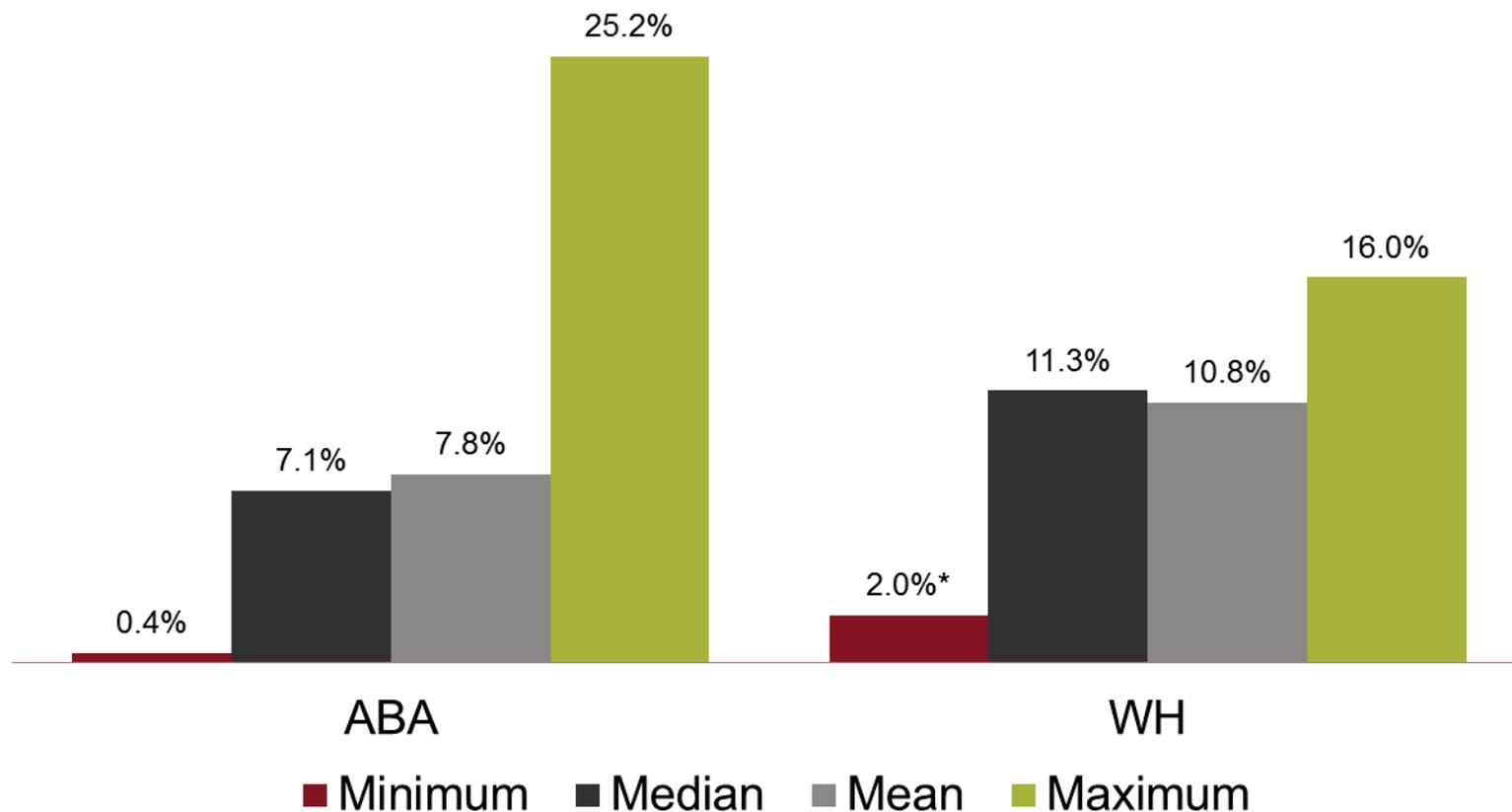
% of Deals with Indemnity Caps (Subset: deals with survival provisions)



Escrows / Holdbacks (Subset: deals with survival provisions)

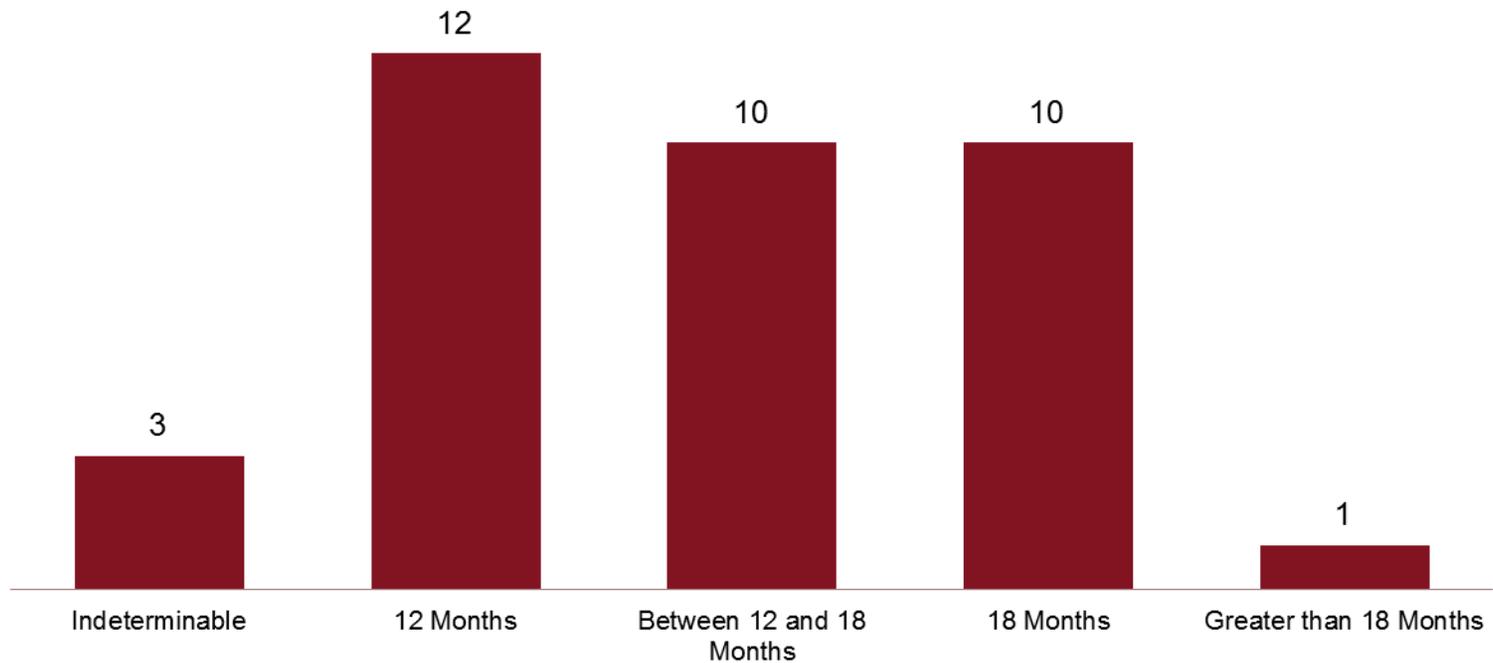


Escrow/Holdback as % of Transaction Value (Subset: deals with determinable escrows/holdbacks)



Escrow Duration Frequency (WH Study Subset: deals with escrows)

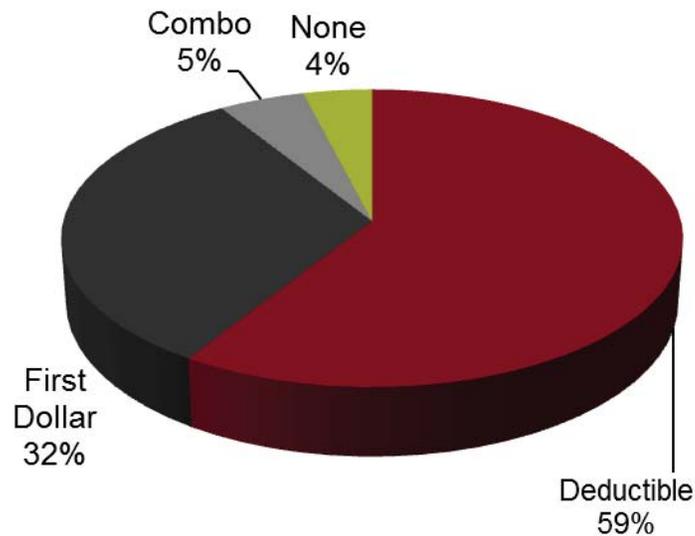
Number of Deals



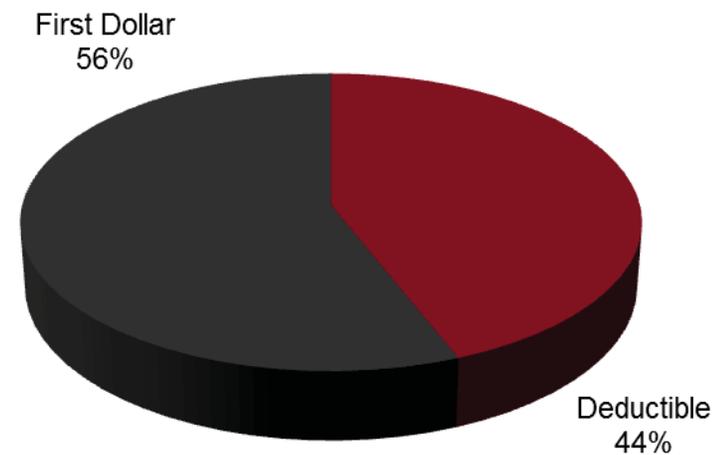
Baskets

(Subset: deals with survival provisions)

ABA

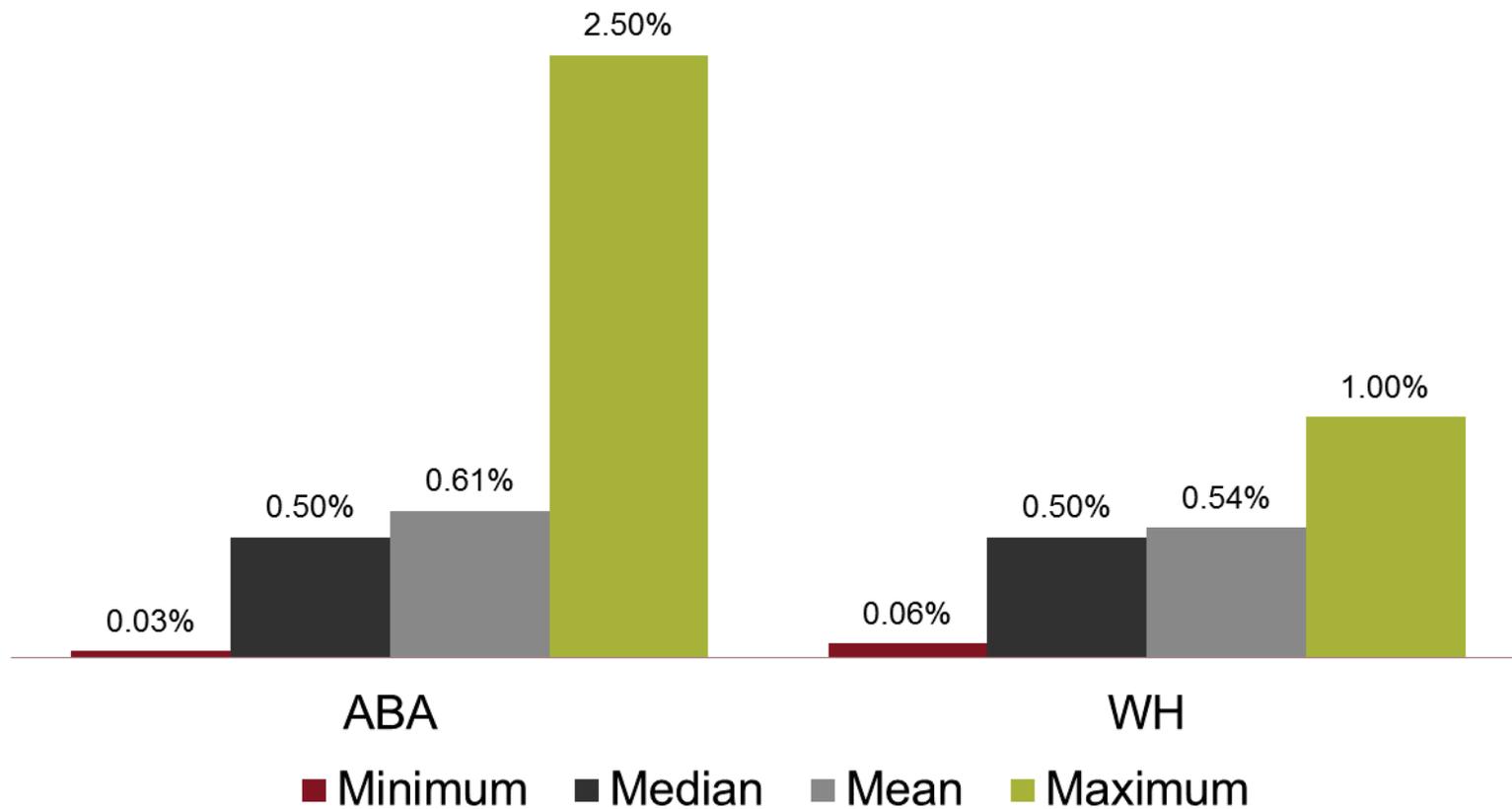


WH*



*A combo approach was observed in 4% of 2008 deals, 2% of 2011 deals, 8% of 2012 deals and 8% of 2013 deals

Basket as % of Transaction Value (Subset: deals with survival provisions)



Extra-Contractual Claims and Threats to Entity-Specific Contracts

▪ Tort Q&A:

- Assuming you can otherwise establish a material representation was made to you that was false when made and upon which you justifiably relied to your detriment, which of the following **mental states** are required in the person making the representation to constitute fraud?
 - the person who made the representation **knew** it was **false** when he made it.
 - the person who made the representation **suspected** it may be **false** when he made it.
 - the person who made the statement **had no idea** whether the statement was **true or false** when he made it.
 - the person **believed** the statement to be **true**, but he had only **limited information** upon which to base his belief.
 - the person **believed** the statement to be **true** and had **substantial information** upon which to base his belief.

Extra-Contractual Claims and Threats to Entity-Specific Contracts

Equitable Theories – “Piercing the Veil” Q&A

- True or False: Most successful piercing cases involving a parent-sub subsidiary relationship are brought by individual plaintiffs.
- What percentage of piercing cases of all types have been successful at the appellate court level across the United States according to a recent survey? (a) 15%, (b) 20%, (c) 30%, or (d) 50%
- True or False: A piercing claim is much more likely to be successful in a case involving a tort claim than in a case based solely upon a contractual relationship?

Many Meanings of the Word “Fraud”

- “Fraud is a many splendored thing.”
 - Common Law Fraud
 - Equitable Fraud
 - Promissory Fraud
 - Unfair Dealings Fraud
- **Question:** When a contract carves-out “claims based on fraud” from the exclusive remedy provision, which of the above is carved out?

Extra-Contractual Claims and Threats to Entity-Specific Contracts (cont.)

Good news - while tort principles are imposed by law, not contractually consented to, they **can be disclaimed by contract between sophisticated parties in most states.**

Non-Reliance

- **Purpose:**
 - Fraud claims and negligent misrepresentation claims generally require proof that a claimant reasonably or justifiably relied on the defendant’s false statement.
 - Non-reliance provisions require the Buyer to state that it did not rely on any extra contractual representations made by the Seller, providing proof of the absence of reliance necessary to support a fraud or negligent misrepresentation claim.
 - The non-reliance provision is specifically intended by sellers to limit fraud liability.

- **Items to Consider:**
 - When representing Sellers, remember:
 - A typical “entire agreement” provision is not sufficient to disclaim Buyer’s reliance on extra-contractual reps
 - The agreement must include a provision by Buyer disclaiming reliance on extra-contractual reps (and the absence of a disclosure of any specific fact) and must be specific.
 - When representing Buyers:
 - Ensure that all info and oral assertions on which Buyer is relying are covered by express representations in the Agreement.

More on Non-Reliance

How State Law Interpretation Differs:

- **In Texas, Delaware, New York, Rhode Island** and many other states, the non-reliance provision is effective to waive or preclude a fraudulent inducement claim based on prior or extra-contractual representations (oral or written). See *Italian Cowboy Partners*. See also *McLernon v. Dynegy, Inc.*, 347 S.W.3d 315 (Tex. App.—Houston (14th Dist.) 2011).
 - Note, however, **in New York**, to be effective, the non-reliance provision must specifically refer to the types of representations that the counterparty could allege were made outside of the agreement and relied on by the counterparty (which may include informational categories (e.g., financials) or means of access (e.g., data rooms, management presentations, responses to questions submitted by buyer)). See *Caiolo v. Citibank, NA.*, 295 F.3d 312, 317–18 (2d Cir. 2002).
- **In Florida, California, South Carolina, Alabama, Kansas, Missouri, Nevada, New Hampshire, Oregon and Wisconsin**, courts disfavor the enforcement of contractual limitations on liability, in particular a general non-reliance provision, as they relate to extra-contractual fraud:
 - **In Florida**, in order to effectively waive or preclude a fraudulent inducement claim, the agreement must also expressly state that the parties waive their right to make a fraud claim or otherwise seek a remedy for being fraudulently induced to enter into the agreement. See *Lower Fees, Inc. v. Bankrate, Inc.*, 74 So. 3d 517 (Fla. App. 2011).
- **In Mass. and Wyoming**, courts fall somewhere in the middle—allowing intentional fraud claims but enforcing non-reliance provisions against negligent misrepresentation claims.

Examples of Negotiated Fraud Carve-outs

[N]othing herein shall operate to limit the common law liability of any Seller to Purchasers for fraud in the event such Seller is finally determined by a court of competent jurisdiction to have willfully and knowingly committed fraud against any Purchaser, with the specific intent to deceive and mislead any Purchaser, regarding the representations and warranties made herein or in any schedule, exhibit or certificate delivered pursuant hereto.

Asset Purchase Agreement, dated Jan. 23, 2014, by and among Florida Rock Industries, Inc., Florida Cement, Inc., Argos Cement LLC, Argos Ready Mix LLC, and, solely for purposes of Section 12.18, Vulcan Materials Company and Cementos Argos S.A., § 8.6, at 55, <http://us.practicallaw.com/7-555-7066>.

Examples of Negotiated Fraud Carve-outs (cont.)

And, an actual defined term for Fraud that is then used in the fraud carve-out to the exclusive remedy provision:

“Fraud” means, with respect to a Party, an actual and intentional fraud with respect to the making of the representations and warranties pursuant to Article IV or Article V (as applicable), provided, that such actual and intentional fraud of such Party shall only be deemed to exist if any of the individuals included on Section 1.1(vv) of the Seller Disclosure Letter (in the case of the Seller) or Buyer Disclosure Letter (in the case of the Buyer) had actual knowledge (as opposed to imputed or constructive knowledge) that the representations and warranties made by such Party pursuant to, in the case of the Seller, Article IV as qualified by the Seller Disclosure Letter, or, in the case of the Buyer, Article V as qualified by the Buyer Disclosure Letter, were actually breached when made, with the express intention that the other Party rely thereon to its detriment.

Stock Purchase Agreement, dated December 10, 2013, by and between LBD Acquisition Company, LLC (“Buyer”), and Fifth & Pacific Companies, Inc. (“Seller”), regarding the purchase and sale of the capital stock of Lucky Brand Dungarees, Inc., § 1.1(ll), at 5, <http://us.practicallaw.com/4-552-0885>.