



COOLEY MARKET TRENDS SNAPSHOT 2011

NOTABLE PUBLIC TARGET TRENDS

Fiduciary exception to Target Board Recommendation Covenant. There has been a consistent shift in recent years from a simple right to change the Board recommendation "if fiduciary duties require" exception (55% of deals in 2008, 43% of deals in 2009 to 28% of deals in 2010) to an exception limited to a "superior offer or intervening event" (from 13% of deals in 2008 to 27% of deals in 2009 to 32% of deals in 2010).

Reverse Break-Up Fees. In deals with reverse break up fees (typically limited to deals with financing risks and antitrust sensitive deals), the prevailing structure from 2005-2007 during the private equity boom was to match the size of the reverse break-up fee to the target company's break-up fee. Since then, reverse break up fees have trended to being significantly larger than the typical target company's break-up fee.

Contingent Value Rights. While earn-outs in public transactions are far less common than in private transactions, Contingent Value Rights (or CVRs) have been increasingly used to bridge valuation gaps in public deals, particularly in pharmaceutical and life sciences transactions, and for other contingent events with a binary impact on value such as plaintiff litigation outcomes. The sanofi-aventis/Genzyme transaction in 2011 included a \$4 billion face value CVR, which is the largest in history to date.

Stockholder Litigation. Stockholder litigation post-announcement of public deals has become a virtual certainty and has influenced disclosure practices in tender offers, S-4 registration statements and merger proxy statements, particularly with respect to financial projections and fee arrangements and potential conflicts with financial advisors. We expect that the plaintiffs' bar may be emboldened by recent attorney fee awards and increasingly seek settlements involving changes to deal protections rather than agreeing to disclosure only based settlements. These developments (including the associated deal costs) may in turn influence how the M&A Bar approaches the aggressiveness of the mix of deal protections used in transactions.

NOTABLE PRIVATE TARGET TRENDS:

Earn-Outs. There has been a continued increase in the use of earn-outs, which in one study were in 38% of deals in 2010 (up from 19% in 2006 and 29% in 2008). The increased use of earn-outs to bridge valuation gaps after the slowdown in 2007 was widely predicted. The continued increase in the use of earn-outs in 2010 after deal activity began to increase again was not anticipated and indicates a continued disconnect between buyers and sellers on valuations because of continued market volatility.

Purchase Price Adjustments. The use of purchase price adjustment mechanisms (primarily working capital) continued to increase from 68% of deals in 2006, to 79% of deals in 2008, and now to 82% in 2010. While the majority of the adjustments continued to be, at least in part, tied to working capital, the complexity in the way these adjustments were drafted increased.

Legal Opinions. Delivery of legal opinions in private target deals is becoming infrequent. An opinion was delivered in only 27% of deals in 2010 (down from 70% in 2006 and 58% of deals in 2008).

Non-Reliance Clauses. “No other reps” and “non-reliance” clauses are now in the majority of deals. In 2010, 72% of deals contained these clauses in some form, up from 45% in 2008. We believe the increased use of these clauses is a result of case law developments and the attention these cases were given among the M&A bar.

INDEMNIFICATION

Fraud Claims and Covenant Breaches. There has been a significant increase in the specific treatment of fraud-based claims and breaches of covenants in indemnification sections of agreements. In 2006 and 2008, fraud was carved-out from the survival of representations limitations in 37% of deals. Breach of covenants was carved-out 36% of the time. In 2010, fraud was specifically carved-out in 82% of deals and covenant breaches 77% of deals. Venture backed sellers are particularly sensitive to the fraud exception, and we have seen increasing focus on limiting fraud to common law fraud (rather than a generic reference to fraud – which can include negligent misstatements in some jurisdictions—and intentional misrepresentations), and limiting the fraud exception to the indemnifying party’s own fraud or capping liability for fraud except in the case of one’s own fraud.

Incidental, Consequential and Punitive Damages. There has been a continued increase in the specific treatment of incidental, consequential and punitive damages in the indemnification section. The parties are now increasingly explicitly stating in the contract that the buyer is (or is not) entitled to recover incidental and/or consequential damages and punitive damages are increasingly limited to situations where awarded in third party claims.

Liability Cap. In one study, the general indemnification liability cap dropped significantly, with 43% of deals having the cap at less than 10% of deal value (29% in 2008 and even fewer deals in 2006). 57% of deals in 2010 had the cap at 10% or less (the SRS study had this number at 41%). Transactions in which Cooley represented the buyer or seller, however, have not shown this trend. In addition, we believe the size of deals has a significant influence on the dollar amount of the liability cap, with the larger deals or deals with a competitive sales process generally commanding lower percentages.

Basket Carve-Outs. There has been a continued increase in carve-outs from baskets generally. Capitalization, authority, organization and taxes are all now excluded from the basket in at least 50% of deals.

“Double” Materiality Scrapes. The Materiality Scrape (meaning that all materiality and material adverse effect limitations in the representations and warranties are ignored) in some form is now in at least half of all deals (the 2011 SRS Study showed it in 81% of deals and the ABA Study showed it in 49% of all deals in some form). However, the frequency of the buyer-favorable formulation that “scrapes” materiality for determining breach of representations and warranties (as opposed to calculating damages only) is still limited to 25% of deals per the SRS Study and only 17% of deals in the ABA Studies. We note that depending on how the bringdown to the representations in the closing condition is drafted, a double materiality scrape may have the effect of making the negotiation of representations and warranties based on concepts of materiality a meaningless exercise.

NOTABLE 2011 CASES

In re Airgas Inc. Shareholder Litigation (Del Ch. February 15, 2011) finding the Airgas Board was not obligated to redeem its poison pill to enable a hostile tender offer at an inadequate price

In re Del Monte Foods Company Shareholder Litigation (Del Ch. February 14, 2011) and subsequent settlement, enjoining stockholder vote for 20 days and enforcement of certain deal protections due to Board’s failure to provide serious oversight of its financial advisor’s misconduct; \$89.4 million settlement, with \$23.7 million paid by Barclays

In re Art Technology Group Inc. Shareholders Litigation (Del Ch. December 20, 2010) enjoining a merger until the target disclosed additional information about its financial advisor’s prior work for the buyer

In re Atheros Communications Shareholder Litigation (Del Ch. March 4, 2011) enjoining target stockholder vote on a merger until the target disclosed the amount of the almost entirely contingent fee payable to its financial advisor

In re Southern Peru Cooper Corporation Shareholder Derivative Litigation (Del Ch. Oct 14, 2011) finding a violation of the entire fairness test in acquisition of a business owned by a controlling stockholder due to the special committee's undervaluation of buyer's stock used as currency; awarding \$1.26 billion in damages

Meso Scales Diagnostics LLC v. Roche Diagnostics GmbH (Del Ch. March 4, 2011) declining to dismiss a claim that a reverse triangular merger effected an assignment of rights under a contract which required consent for assignments "by operation of law"

In re Smurfit-Stone Container Corp. Shareholder Litigation (Del Ch. May 20, 2011) and *Steinhardt v. Howard-Anderson* (Del Ch. Jan 24, 2011) holding that Revlon duties apply in transactions with 50% stock/50% cash consideration

Ventas, Inc. v. HCP, Inc. (6th Cir., May 17, 2011) affirmed over \$100 million judgment for tortious interference payable to a winning bidder by an interloper who violated a standstill with the target to submit a competing bid and caused the price to obtain target stockholder approval to increase

In re Orchid Cellmark Inc. Shareholder Litigation (Del Ch. May 12, 2011) declining to issue an injunction; court held that target was only required to disclose the financial projections that were relied upon not all projections target created; mix of covenant not to redeem a poison pill and other deal protections acceptable; equity value is the proper measure for the size of the break up fee

In re Openlane Inc. Shareholders Litigation (Del Ch. Sept 30, 2011) confirming the use of a "sign and consent" method to address restrictions against a fully locked merger transaction set forth in the 2003 *Omnicare v. NCS Healthcare* decision

SOURCES

- Cooley LLP internal proprietary database
- American Bar Association M&A Committee Deal Points Surveys (both public target and private target studies) at www.abanet.org/dch/committee.cfm?com=CL560003
- Shareholder Representative Services M&A Deal Terms Study at www.shareholderrep.com/files/study.pdf
- Reverse Break-up Fees and Specific Performance: A Survey of Remedies in Public Deals, published by Practical Law Company

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