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# M&A Trends and Antitrust Developments Affecting Dealmaking

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# Bridging Valuation Gaps

# VALUATION GAPS IN DEAL MAKING

- **Disagreements over valuation of businesses or assets ("valuation gaps") are common, particularly in times of market disruption.**
- **Participants and their advisors have developed a number of ways to bridge these differences and get deals done.**
- **Common strategies include:**
  - Earn-outs
  - Options
  - Majority Equity Acquisitions

# EARN-OUTS

- **Earn-outs involve deferring some portion of the deal consideration until after closing and tying it to one or more contingencies, such as financial performance of the acquired business or the occurrence of key events (e.g., marketing approval of a product).**
- **Key considerations:**
  - Earn-outs can often lead to disputes.
  - Important to be very clear about what Buyer's obligations to support the achievement of the earn-out are (and are not).
  - Calculations for determining earn-out payments should be detailed and supported by examples.
  - Tax and accounting implications should be carefully assessed.
  - Planning ahead for disputes by agreeing on dispute resolution protocols can be very helpful.

# OPTIONS

- **Options over a business or assets involve an agreement that allows a buyer to trigger an acquisition at some future time, often following the occurrence of a particular event (e.g., after receipt of clinical trial data).**
- **Key considerations:**
  - Option agreement should be accompanied by a fully-negotiated purchase agreement that will become effective upon option exercise. Anything less risks disagreement at a time when the parties' leverage is divergent.
  - Metrics for determining the purchase price must be clear and ideally supported by examples.
  - Covenants covering the period between option signing and exercise (or termination) require careful consideration.

# MAJORITY ACQUISITIONS

- **Acquisition of a majority stake allows a buyer to gain control without fully committing to an acquisition, permitting the parties to share going-forward risk.**
- **Key considerations:**
  - Typically put and call mechanisms will be involved, allowing the buyer to gain full control/seller to fully divest. Details of these structures, particularly in relation to pricing, must be carefully defined.
  - Fiduciary and other obligations to minority shareholder(s) must be addressed.
  - Consideration must be given to minority shareholder rights, particularly consent rights and information rights relating to matters that may bear on the pricing of the remaining stake.

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# Artificial Intelligence Considerations in Due Diligence and Transaction Agreements

# DUE DILIGENCE QUESTIONS - MODELS

- Does the company use AI models (including algorithms, systems or technologies that rely on deep learning, machine learning, generative adversarial networks, large language models, or statistical learning (e.g., linear regression, logistic regression, support vector machines, nearest neighbor, decision trees, primary component analysis, naive Bayes classifier, k-means clustering)) in its business?
- What AI models are used by the company and for what purposes?
- How are the AI models trained (e.g., supervised learning, unsupervised learning, reinforcement learning)?
- How frequently are the AI models updated and retrained?

# DUE DILIGENCE QUESTIONS - DATA

- What data has been used to train and test the AI models, and what are the sources of that data?
- What agreements, if any, govern the company's use of that data, and what are the terms of those agreements?
- If the company lets customers, clients, or other third parties make use of the AI models, what rights does the company have to use the input and/or output data arising from that use?
- Does the company have agreements with its data licensors ensuring continued access to new training data?

# DUE DILIGENCE QUESTIONS – TOOLS AND TALENT

- What third party tool providers does the company rely on to support the AI models, and what are the terms of its agreements with those providers?
- What data scientists or other relevant AI talent does the company rely on to maintain, improve, and manage the AI models and data, and what are the terms of its agreements with that talent?

# DUE DILIGENCE QUESTIONS – INTELLECTUAL PROPERTY

- Does the company own the intellectual property rights to all AI models that it uses in its products?
- If so, do these rights include patent rights or copyrights?
- If licensed third party data is used to train the AI models, what intellectual property rights does the company have in the resulting evolutions of those models?

# DUE DILIGENCE QUESTIONS – LITIGATION RISK

- What technical measures does the company take to mitigate risks of litigation associated with the use of AI?
- Are there any ongoing or potential lawsuits related to the company's AI technology?

# DUE DILIGENCE QUESTIONS – FAIRNESS AND TRANSPARENCY

- Does the use of AI models by the company or its licensees result in predictions about individuals, and if so what steps does the company take to ensure the AI models are not biased against individual in protected classes?
- Are the data sets used for training the AI models representative of the populations potentially affected by the models' use, and if not, how is this discrepancy addressed?
- What procedures or practices does the company have in place for ensuring that AI results are explainable to individuals affected by those results?

# DUE DILIGENCE QUESTIONS – COMPLIANCE AND ETHICS

- Is the company's use of AI compliant with relevant local, national, and international regulations?
- Are there potential risks associated with changes to regulatory environments? How has the company planned for potential risks associated with changes to the relevant regulatory environments?
- What policies does the company have in place for responsible AI usage?
- Is there an AI ethics board or governance structure in place?

# REPRESENTATIONS AND WARRANTIES

"AI Technologies" means any and all deep learning, machine learning, and other artificial intelligence technologies, including any and all: (a) proprietary algorithms, models, software, or systems that make use of or employ neural networks, statistical learning algorithms (such as linear and logistic regression, support vector machines, random forests, or k-means clustering), or reinforcement learning; (b) proprietary embodied artificial intelligence and related hardware or equipment; and (c) each update, upgrade, change and evolution of such technologies.

"AI Training Data" means training data, validation data, and test data or databases used to train or improve any AI Technology.

"Process" or "Processing" or "Processed" means, with respect to data (including Personal Data), any operation or sets of operations which is performed on such data, whether or not by automated means, such as the use, collection, processing, access, storage, recording, organization, structuring, adaptation, enrichment, alteration, transfer, retrieval, generation, consultation, analysis, disclosure, dissemination (or otherwise making available), alignment or combination, restructuring, erasure or destruction of such data, including for purposes of training AI Technologies.

"Software" means (a) software, computer programs, applications, systems, code, data, databases, and information technology, including firmware, middleware, drivers, system monitoring software, algorithms, models, methodologies, program interfaces, source code, object code, html code, and executable code; (b) Internet and intranet websites, databases and compilations, including data and collections of data, whether machine-readable or otherwise; (c) AI Technologies; (d) development and design tools, utilities, and libraries; (e) technology supporting websites, digital contents, user interfaces, and the contents and audiovisual displays of websites; (f) all versions, updates, corrections, enhancements, and modifications thereto; and (g) media, documentation and other works of authorship, including forms, user manuals, developer notes, specifications, comments, schematics, emulation and simulation reports, support, maintenance and training materials, and other documentation relating to or embodying any of the foregoing or on which any of the foregoing is recorded.

# REPRESENTATIONS AND WARRANTIES

All output generated by AI Technologies included in or used in connection with any Company Offering ("AI Output"), is and has been accurate, timely and generated automatically and without human assistance. No Acquired Company has been required or requested by a customer to correct any AI Output, and no Acquired Company has otherwise corrected any AI Output before or after providing it to a customer. All AI Technologies included in or used in connection with any Company Offering rely solely on unsupervised machine learning algorithms for training purposes, and the Acquired Companies[, to the Knowledge of the Company,] own all AI Technologies that are necessary to provide materially similar benefits as are provided in existing Company Offerings for the following anticipated use cases: [Other use cases].

Each Acquired Company has at all times: (i) provided adequate notice and obtained any necessary consents required and in the manner prescribed under any Data Protection Laws for the Processing of Personal Data as conducted by or for such Acquired Company or its Third Party Processors, and (ii) abided by any privacy choices (including opt-out preferences) relating to Personal Data as required by any Data Protection Law (such obligations, along with those contained in such Acquired Company's privacy policies and in Acquired Company Data Agreements, collectively, "Acquired Company Privacy Commitments"). No Acquired Company has at any time used Personal Data to train its AI Technologies in a manner that violates any Data Protection Law, Acquired Company Privacy Commitments or Acquired Company Data Agreements.

Schedule [X](i) sets forth a true, correct and complete list, as of the date hereof, of each distinct electronic or other repository or database containing (in whole or in part) Company Data maintained by or for any Acquired Company at any time, the types of Company Data in each such database, and the means by which the Company Data was collected or received. Schedule [X](ii) sets forth a true, correct and complete list, as of the date hereof, of all Contracts under which any Acquired Company has acquired, licensed, or otherwise received, collected, or used any Company Data.

Each Acquired Company maintains or adheres to commercially reasonable policies and procedures consistent with standards in the industry relating to data governance and data management of Company Data, including policies, protocols and procedures for assessing and ensuring the availability, usability, consistency, integrity and security of Company Data.

# REPRESENTATIONS AND WARRANTIES

Each Acquired Company has valid and subsisting contractual rights to Process or to have Processed any Acquired Company Third Party Data howsoever obtained or collected by or for such Acquired Company in the manner that it is Processed by or for such Acquired Company, and no Acquired Company has received any written notice within the six (6)-year period prior to the date hereof alleging otherwise. Each Acquired Company has conducted commercially reasonable due diligence to confirm that it has such rights with respect to the applicable Acquired Company Third Party Data prior to entering into any Acquired Company Data Agreement or otherwise permitting a Third Party to access or otherwise use any Acquired Company Offering. Each Acquired Company has all rights, and all permissions or authorizations required (including under Data Protection Laws, Acquired Company Data Agreements, the Acquired Company Terms of Use and other relevant Contracts) to retain, produce copies, prepare derivative works, disclose, combine with other data, and grant third parties rights, as the case may be, to all Acquired Company Third Party Data as necessary for the conduct of business by such Acquired Company as currently conducted. To the extent that an Acquired Company's rights to use Acquired Company Third Party Data under any Acquired Company Data Agreement or other relevant Contract are more limited than those granted under the Acquired Company Terms of Use, such Acquired Company has at all times complied with such Contract through the existing functionality of the applicable Acquired Company Offering and without manual interference therewith.

Each Acquired Company maintains or adheres to commercially reasonable policies and procedures consistent with standards in the industry relating to the ethical or responsible use of AI Technologies at and by such Acquired Company, including policies, protocols and procedures for: (i) developing and implementing AI Technologies in a way that promotes transparency, accountability, and human interpretability; (ii) identifying and mitigating bias in Training Data or in the AI Technologies used in the Acquired Company Offerings, including implicit racial, gender, or ideological bias; and (iii) management oversight and approval of such Acquired Company's employees' and contractors' use and implementation of AI Technologies (collectively for the Acquired Companies, "Acquired Company AI Policies"). All AI Technologies included in or used in connection with any Acquired Company Offering were developed and tested in a manner consistent with best industry standards by [MindBridge Principals] and professionals in the fields of audit and accounting in accordance with their professional standards.

# REPRESENTATIONS AND WARRANTIES

During the six (6) years prior to the date of this Agreement, there has been: (i) no material actual or alleged non-compliance with any of the Acquired Company AI Policies; (ii) no material actual or alleged failure of an Acquired Company Offering to satisfy the requirements specified in any Acquired Company AI Policies; (iii) no complaint, claim, proceeding, or litigation alleging that Training Data used in the development, improvement, or testing of any Acquired Company Offering was falsified, biased, untrustworthy, or manipulated in an unethical or unscientific way and no report, finding, or impact assessment of any internal or external auditor, technology review committee, independent technology consultant, whistle-blower, transparency or privacy advocate, labor union, journalist, academic, or similar third-party that makes any such allegation; and (iv) no request from any Governmental Authority concerning any Acquired Company Offering or related AI Technologies (except for requests that do not and are not reasonably expected to adversely affect in any material respect the Acquired Companies' use of any Acquired Company Offering or related AI Technologies).

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# Representation & Warranty Insurance Overview and Update

# OVERVIEW

***Transactional Risk insurance products have been available in the United States since the mid-1990's***

***Over the last 10-15 years, the use of these products has skyrocketed***

Roughly half of US deals now use RWI

25 US RWI insurers – over $1B in capacity

***The growth has been driven by:***

Better mousetrap

Speed of the deal

Regulated industry whose sole purpose is to manage risk

"If it's gray, we'll pay"

# OVERVIEW (CONT'D)

***Initially sponsors were primary users but strategics are increasingly jumping on bandwagon***

RWI policies now split evenly between strategics and sponsors

***Market's ability to insure larger deals increasing as well***

All but the very largest deals can now be insured

Insurance towers – primary + one or more layers of excess

***Insurance may not make sense in all deals, but it's something that should at least be considered as an option – on the checklist***

# OVERVIEW (CONT'D)

***Specific situations***

Acquisitions of public companies – RWI (somewhat surprisingly) still rare

Banker-led auction for privately held company – RWI almost a certainty (unless buyer is willing to take the risk and effectively self-insurance)

- Often "non recourse" deals – i.e., buyer relies entirely on RWI
- "Seller flip"

# R&W INSURANCE PROCESS

***Buyer/Insured retains broker***

***Broker assembles small package of information about target – Offering Memo, Financials, etc.***

***Broker packages info and seeks quotes from market***

Competitive process

- Multiple insurers competing for deal
- Results in better terms for buyer/insured

***Broker summarizes/compares quotes***

Premium, retention, exclusions, etc.

Tip: Work with broker to highlight any unique aspects of deal at this stage

Much better for insurer to understand now than later

# R&W INSURANCE PROCESS (CONT'D)

***Chosen Insurer provides Non-Binding Indication (NBI)***

Effectively term sheet

Referred to as non-binding but effectively binding

Buyer/insured commits to insurer's diligence fee

***Underwriting***

Insurer "due diligences the due diligence"

Provide insurer all due diligence reports

- Need some kind of written reports
- As discussed, this needs to be a key focus

Review of purchase agreement/schedules

Underwriting call

Deal timing dictates insurance timing

# R&W INSURANCE PROCESS (CONT'D)

***Negotiation of policy***

Has become much more streamlined

Start with previously negotiated precedent reflecting current market terms (which are insured-friendly)

The only policy terms that are typically heavily negotiated are deal-specific exclusions

***Policy bound/Premium paid***

# TYPICAL RWI TERMS

| | |
|---|---|
| • **Coverage:** | • Provides Buyer with insurance against a breach of the Seller<br>• Representations and Warranties as stated in the Purchase and Sale Agreement<br>• Also, coverage for pre-closing taxes<br>• Coverage includes both losses and legal and defense costs |
| • **Coverage Limit (i.e., amount of insurance coverage):** | • 10% - 20% of enterprise value |
| • **Retention (deductible):** | • 1% (or less) of enterprise value; often drop down after certain period of time |
| • **Premium:** | • 2% - 4% of purchased limit |
| • **Due Diligence Fee:** | • $15,000 to $45,000 in addition to the premium |
| • **Coverage Period:** | • General Representations: 3 years<br>• Fundamental and Tax Representations: 6 years<br>• ***Often can negotiate "extended" coverage on particular reps |
| • **Effective Date:** | • Typically bound at closing; can have "interim breach" coverage |
| • **Exclusions:** | • Standard exclusions (see next page)<br>• Deal-specific exclusions – e.g., identified risk; inadequate diligence |

# TYPICAL RWI TERMS (CONT'D)

- **Standard Exclusions:**
  - ✓ Purchase price/working capital adjustment
  - ✓ Actual knowledge of breach
  - ✓ Any matter disclosed in any disclosure schedule – no breach
  - ✓ NOLs
  - ✓ Pension underfunding/withdrawal liability
  - ✓ Forward looking statements
  - ✓ Asbestos, PCBs and CF

# TYPICAL RWI TERMS (CONT'D)

***Example***

Deal Value: $250,000,000

Coverage Limit: $25,000,000 (i.e., 10% of deal value)

Premium: $750,000 (i.e., 3% of Coverage Limit; likely lower than 3% in current competitive market)

Retention: $2,500,000 (i.e., 1% of deal value)

# TWO COMMON APPROACHES

***While of course buyer and sellers approach RWI in a variety of bespoke ways to fit the circumstances of a particular deal, the two most common approaches are:***

Common Approach #1:  Buyer and Seller share retention

- Buyers often want sellers to have at least some "skin in the game" to provide comfort that the seller is approaching the representation/disclosure process in a diligent manner
- Accomplish this by having buyer and seller share retention
  - Buyer responsible for first 50% of retention through traditional purchase agreement deductible
  - Seller responsible for second 50% of retention through indemnity escrow
  - Once retention satisfied, any further breach claims covered by RWI

# TWO COMMON APPROACHES (CONT'D)

Common Approach #2:  No Seller Indemnity/Nonrecourse

- When Sellers have leverage (e.g., competitive auction setting), they will typical seek (and often get) a "non recourse" deal
- This is where Sellers have no liability for breaches of reps (often subject to a fraud exception)
  - Rather, the buyer/insured can look only to the RWI (or self insure)
  - But remember – known issues are not covered by RWI
  - Thus, if there is an issue with target discovered in diligence or disclosed on schedules, Buyer will either have to accept that risk/liability or seek another avenue of recourse (line item indemnity, different type of insurance, etc.)

# CURRENT MARKET – INFLECTION POINT?

***Combination of recent slow down of M&A market and continued increase of RWI capacity has hit industry hard***

***More insurers competing for fewer deals***

***Result has not been surprising – terms have become much more insured –friendly***

Lower premiums (now often close to 2%)

Lower retentions (now almost always below 1%)

Broader coverage

# CURRENT MARKET – INFLECTION POINT (CONT'D)

*This is all good news for insureds, right?*

*Answer is maybe*

*Has the feel of a race to the bottom – terms not sustainable*

*Recent statement from head of Euclid: "current rates may not adequately support the costs of the significant resources required to address the M&A market's stated desire for efficient underwriting processes and fair and commercial claims handling"*

*Not clear how this will shake out, but for now the advice is the insurer matters – not just a commodity on which a decision can be made only on terms*

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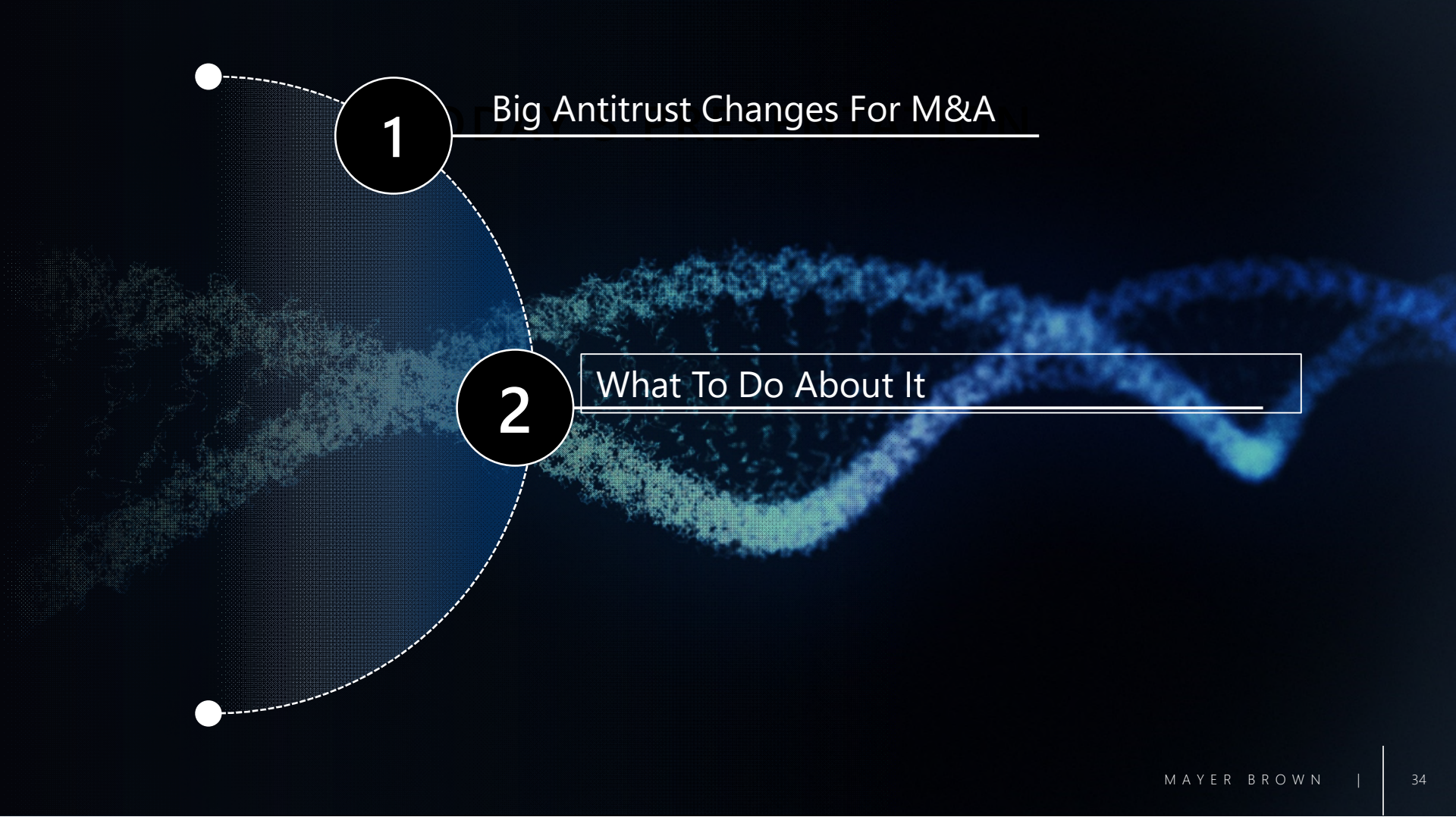
# Antitrust/M&A Trends: Navigating Antitrust Risk


1
Big Antitrust Changes For M&A
2
What To Do About It

# HSR REVISIONS

***BACKGROUND***

***Proposed rulemaking***

***Public comment period -> promulgation***

**IMPLICATIONS**

**Notice filing -> European-style upfront disclosures**

**Detailed information & narratives on contested issues**

**Expansive document demands**

- Expands scope of documents to be submitted
- Takes away "draft" exclusion
- Affects all involved in deal

**When does the shot clock start?**

- When will 30-day clock begin to run?

**Document holds**

- Confirm that you've preserved docs/info
- Means suspending auto-delete policies
- Lasts until waiting period ends

# MERGER GUIDELINE REVISIONS: CONFIRMS EXISTING AGENCY VIEWS

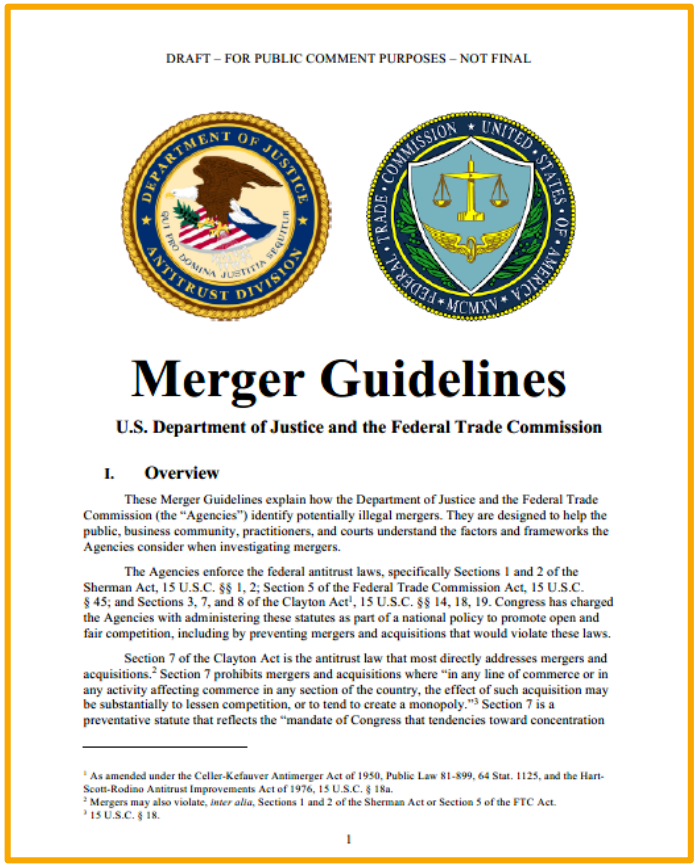
*Agencies prefer organic growth to M&A*

*Impact of new guidelines?*

*Signals how much attention your deal will get at the agencies*

*Survive future antitrust leadership?*

*Persuasive in court?*



DRAFT – FOR PUBLIC COMMENT PURPOSES – NOT FINAL

**Merger Guidelines**

**U.S. Department of Justice and the Federal Trade Commission**

**I. Overview**

These Merger Guidelines explain how the Department of Justice and the Federal Trade Commission (the "Agencies") identify potentially illegal mergers. They are designed to help the public, business community, practitioners, and courts understand the factors and frameworks the Agencies consider when investigating mergers.

The Agencies enforce the federal antitrust laws, specifically Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2; Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45; and Sections 3, 7, and 8 of the Clayton Act[1], 15 U.S.C. §§ 14, 18, 19. Congress has charged the Agencies with administering these statutes as part of a national policy to promote open and fair competition, including by preventing mergers and acquisitions that would violate these laws.

Section 7 of the Clayton Act is the antitrust law that most directly addresses mergers and acquisitions.[2] Section 7 prohibits mergers and acquisitions where "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[3] Section 7 is a preventative statute that reflects the "mandate of Congress that tendencies toward concentration

[1] As amended under the Celler-Kefauver Antimerger Act of 1950, Public Law 81-899, 64 Stat. 1125, and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.
[2] Mergers may also violate, *inter alia*, Sections 1 and 2 of the Sherman Act or Section 5 of the FTC Act.
[3] 15 U.S.C. § 18.

1

# RECENT SETTLEMENTS

***DOJ settled Assa Abloy/Spectrum***

***FTC recently settled Amgen/Horizon & ICE/Black Knight***

***Settlements reflect traditional remedies***

- Assa Abloy/Spectrum:  Divestiture
- ICE/Black Knight:  Divestiture
- Amgen/Horizon: Conduct remedy ("Do not bundle" plus prior notice/approval provisions for limited future deals)



# PRACTICAL ACTIONS: DOCUMENT HYGIENE

"Following one acquisition, a USAP executive put it more bluntly:

**"Cha-ching!"**

*-FTC complaint,*

*FTC v. USAP*

# PRACTICAL ACTIONS: DOCUMENT HYGIENE

The new HSR rules require all **drafts** of competition-related deal documents to be produced -- including from the **head of the deal team**.

It's not just deal documents anymore

- **Quarterly reports** for your CEO
- **Plans & reports** for the Board

# PRACTICAL ACTIONS: GET AN EARLY START

Active engagement on antitrust strategy from initial deal consideration – so you know where your risks are

Develop strong “Day 1” advocacy

Allow more time for HSR submission

# PRACTICAL ACTIONS: DEAL TERMS

Reverse termination fees

Drop dead dates

Divestiture limits

Ticking fees

# PRACTICAL ACTIONS: DEALING WITH AGENCIES

Pushback on timing agreements with the federal antitrust agencies

Litigating the fix

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