

***PUBLIC COMPANY CREEP:
Exploring the good, the bad, and the
ugly of concepts and developments
from public target deals that bleed into
private target M&A***

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Introduction

- **Indemnification**
- **Scope of Representations and Warranties**
- **More Precise/Tightened Conditionality**
- **Appraisal Rights**
- **Williams Act/Tender Offer Issues**
- **Shareholder Litigation**
- **Stockholder Approval with Different Classes of Stock**
- **Type of Consideration**

Indemnification

- Until recently, the inclusion of seller indemnity obligations in private target deals has been a foregone conclusion as a means to provide buyers with recourse in the event of certain breaches.
- Recently, due in part to market dynamics, a greater number of private target companies are taking a public company approach to indemnification where the buyer has no (or very limited) post-closing remedies through indemnification provisions.
- According to one data set, as of September 2016, there have been 173 U.S. private target deals announced in 2016, 27 of which did not provide indemnification protection to the buyer.*
- Anecdotally, sellers of private target companies, especially among PE sponsors, have become more comfortable advocating for, and buyers are more comfortable accepting, “public-style deals.”

* Source: *Practical Law/Thomson Reuters (based on agreements available on EDGAR).*

Indemnification

(Cont'd)

- The sellers in private target deals will more frequently insist on buyers relying on diligence and closing conditionality, similar to public target deals rather than indemnification.
- As a hybrid approach, certain sellers in private target deals are willing to provide indemnification, but they will require their liability exposure to be capped at the retention/ deductible under a rep and warranty insurance policy retained by the buyer (usually between 1 to 2% of the purchase price).
- A typical rep and warranty policy structure involves:
 - a 3 to 6 year policy term for non-fundamental representations and warranties;
 - a 6 year term for fundamental and tax representations and warranties;
 - as noted above, a retention/ deductible between 1 to 2% of the purchase price;
 - often an escrow or indemnity will serve as the source of funding for the insurance policy retention/ deductible; and
 - a cost to the policy holder of (a) a premium equal to 3 to 4% of the limits purchased (which can be up to 100% of the purchase price), (b) state taxes, typically 2 to 4% of the premium and (c) the cost of due diligence performed by the underwriters (usually in the range of \$15,000 to \$50,000).

Indemnification

(Cont'd)

- Rep and warranty insurance policies usually have exclusions for (among other things):
 - breaches of reps and warranties where there was actual knowledge of the breach;
 - fines/penalties (where uninsurable by law);
 - certain environmental liabilities;
 - underfunded pension liabilities;
 - Medicare/Medicaid exclusions;
 - asbestos related liabilities; and
 - fraud and intentional misconduct.
- The likelihood of the trend to push buyers into relying on rep and warranty insurance in private target deals continuing will likely depend on how willing insurers are to make payouts in connection with claims being made under rep and warranty policies over the next few years.

Scope of Representations and Warranties

- There is also a trend of more frequent use of materiality and MAE qualifiers in private target companies' reps and warranties in private target deals. Therefore, even if there is an indemnity obligation on the part of the sellers, depending on whether there is a materiality scrape for purposes of determining losses, the indemnity obligations with respect to breaches of reps and warranties may not provide very much comfort to a buyer.

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