

# *M&A trends and new best practices*

- ✓ M&A downturn prompts companies to take holistic view during M&A transactions, attending to detail from tax liability to software licensing
- ✓ Online workspaces let companies manage deals with less risk and cost, providing access to all parties from beginning to end
- ✓ Collaborative environments allow buyers to keep track of inventoried litigation and facilitate M&A research for general counsel
- ✓ Companies must be ready for day one, post-merger, following up on third-party approvals from real estate leases to domain licenses

## PRIMING THE BOARD

*Since the Sarbanes-Oxley Act, directors have been charged with gathering more information about M&A deals so that they can make better-informed decisions. Aspects of deals that have come under particularly close scrutiny are change-of-control packages and golden parachutes.*

*Directors have stepped up to the plate, realizing they're obligated to take a more active role in the deal process. Increasingly, directors are responsible for testing management's assumptions, asking why a given deal makes sense. Ideally, the directors evaluating a deal will be independent of management so that they can lend a clear-eyed perspective.*

*When necessary, directors have begun hiring outside consultants to evaluate deals. Making sure independent directors assess a deal and even getting third-party advice can help inoculate the board from legal challenges down the road.*

*As a deal transpires, it's important to share key documents with board members, sometimes in real time. Increasingly, email and online data rooms are facilitating this type of communication between the deal negotiators and the ultimate decision-maker: the board.*

# A changing landscape

In the first six months of 2007, M&A activity hit an all-time high, but there were signs of trouble brewing by the second half of the year. Most observers believe the market peaked in the second quarter of 2007. In that quarter, 1,432 deals were done, relative to just 777 in the third quarter of 2007, according to the Association of Corporate Growth and KPMG.

As funding sources dried up and the recent credit crunch worsened, more deals became 'troubled' and some ultimately were abandoned. Skittish buyers now find themselves rethinking offers, and boards and shareholders are pushing targeted companies to hold out for higher prices. The remorse of buyers and sellers is now commonplace.

This challenging environment forces general counsel and corporate secretaries to take extra care with deals under consideration. In such an environment, executives responsible for M&A need to look at the big picture and ask: *How will this marriage of two different entities actually work?*

At the same time, they can't afford to neglect any of the minute details, such as when and how software licenses can be transferred, whether arrangements have been made to transfer control and ownership of the company's domain name portfolio and websites, and what tax liability the company will assume once the merger has been completed. Failure to attend to these matters could result in post-merger surprises, as well as significant unforeseen cost and risk.

Fortunately, companies can look to technology to help manage these increas-

ingly complex details and source documents in a more efficient and intelligent manner. Innovations like online data rooms – repositories where the documents for a deal are uploaded or scanned and can later be perused or edited by any authorized user – are making it possible to better manage and track the activities of the parties involved in a deal, as well as the myriad documents, ad hoc communications and expenses associated with large deals.

### **More managers and experts involved**

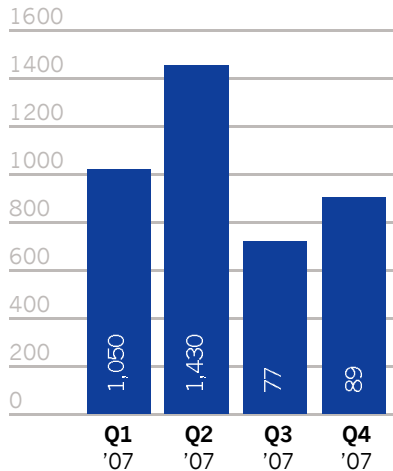
Once upon a time, general counsel and outside counsel ran a deal, with the CFO and CEO popping their heads in every so often. Not so today. As companies have begun to realize how critical personal relationships are to the ultimate success of a merger, far more people have gotten involved.

In this difficult economy, the stakes for each M&A transaction are higher than usual. Bad deals can break companies and oversights can lead to costly litigation. Since companies need to manage the details of each and every deal with extreme care, they are turning to key business managers and specialized experts to help them navigate the risk minefield.

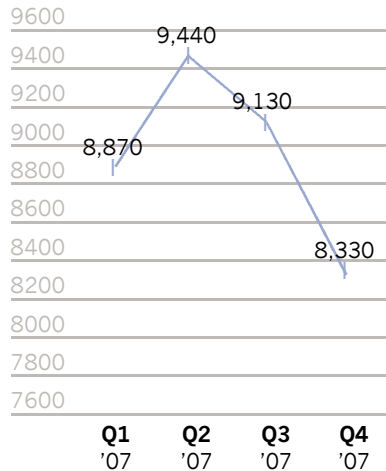
Heads of the various business units can identify where overlaps exist, what gains might be achieved in terms of productivity or efficiency from a proposed merger and what new products might be developed over time. Specialized experts are being asked to make environmental assessments and

### M&A slowed second half of 2007

Value of M&A activity (US\$ billions)



Number of transactions



Source: Thomson Reuters and KPMG

estimate the cost and timeline of information. System integration, as well as potential hurdles that the newly merged company may face with zoning boards and other industry regulators, must be anticipated ahead of time.

The bottom line: Deals are becoming more complex, and there are very few occasions when it's alright to say, 'Let's just do the deal and take the next six months to sort things out.' Nowadays companies have to be ready to begin merging the entities – and reaping the vaunted benefits – as soon as the ink dries on the closing contracts.

Experts say that the first six months of 2008 saw the highest proportion of unfriendly bids since 1999. Some examples: InBev's \$52 billion unsolicited takeover of Anheuser-Busch and Roche's July 2008 bid for the remainder of outstanding Genentech stock.

In some cases, boards are accepting and even welcoming bids that they initially rejected. Regardless, all interactions within a hostile situation need to be carefully documented. The better prepared companies are to address the intricacies

of a deal, the lower the odds of serious problems arising in the future.

#### Boards demanding more

Over the past few years, hedge funds and activist shareholders have demonstrated a marked ability to throw a monkey wrench into a deal, voicing concerns that most likely wouldn't have been raised just a few years ago. Investors have been known to force target companies to return to the bidder and demand more value.

In 2007 hedge funds, other institutional investors and RiskMetrics second-guessed Eli Lilly's plan to buy ICOS, the pharmaceuticals firm that created Cialis. Eli Lilly ultimately raised the offer by \$200 million to \$2.3 billion.

Even though shareholder activism is on the rise, rarely does it spell the end of a deal. According to FactSet MergerMetrics, only 6.19 percent of 2007 deals that had concluded by mid-January 2008 were withdrawn once a definitive agreement had been reached. And of those failed deals, FactSet MergerMetrics says that only 12 percent were withdrawn for a lack of shareholder approval.

### RISE OF E-FILING

During the past few years, many financial institutions have begun to file the majority of their Uniform Commercial Code (UCC) liens electronically. As a result, they've realized both rapid turnaround and significant cost savings.

Making sure that UCCs are correctly recorded is a critical aspect of any deal; only when all UCC filings are current can a financial institution preserve its security interests in the borrower's property.

Online filing has proven very advantageous. It enables the instantaneous confirmation of UCC filings as opposed to the weeks of delay that can occur with paper and postage. At the same time, filing electronically reduces the potential for error. There are complex requirements for UCC records; a lender can lose its priority in terms of security interests if everything isn't handled properly.

Deal participants using online workspaces can view all UCCs and other legal forms filed electronically from this central and easily accessible vantage point. They can also upload related deal documents, collaborate with other parties and prepare closing documents, all within a secure, web-based workspace.

## ARE YOU AUTHORIZED?

*Companies entrusting something as critical as a merger or acquisition to an online environment will naturally have questions.*

*Topping the list is security. In addition to making sure that all of the documents are housed in a password-protected environment with sufficient fire walls, companies also want to make sure there is proper document-level security. Namely, users should be authorized to see certain documents without gaining access to the entire online repository.*

*Online environments also give the deal leader a chance to dictate how documents are used. A general counsel or a corporate secretary might decide that some documents are considered 'view only' and cannot be modified by users. Other documents – those that are assigned to team members for a specific action – can and should be altered.*

*One distinct advantage to online workspaces: it's far easier to keep track of various versions of the same document. Users can see whether a document has been modified, and they can verify that they're using the most up-to-date version.*

# *The new best practices: keeping the end in mind*

One of the latest M&A best practices sounds paradoxical: begin any deal with the end in mind. In other words, companies shouldn't become so obsessed with 'getting the deal done' that they fail to imagine the day-to-day reality of how the merger will actually work.

The new M&A landscape is compelling companies to look at deals more holistically, and even to take a more skeptical view of the outcome. Companies are asking: *What's in it for both parties? Why are we really doing this deal? And what could possibly go wrong?* Some of these frank conversations can help a deal proceed smoothly. Getting issues on the table and clearly articulating concerns can make the whole M&A experience more efficient and positive.

## **Online data rooms**

Technology allows corporate secretaries and general counsel to manage the deal process differently.

Within the past few years, online data rooms – secure, encrypted environments where sensitive documents can be viewed by any authorized individuals – have gained in popularity. In the past few months, however, as the economy continues to worsen and M&A requires more attention to detail than ever, they've truly caught on.

One advantage to an online data room is that it's available 24/7. A company may therefore offer constant access to necessary documents and can speed up the viewing and due diligence process significantly, and often at far lower cost.

Online data rooms can attract more parties to a deal. In a physical data room, only one party can peruse documents at a time. In an online data room, everyone can view

the documents simultaneously. And documents are present and viewable during the closing and in the months immediately afterward; some systems provide a seamless transfer of all documents and data into a post-deal management system.

## **Closing preparation**

Companies are looking beyond using technology solely for the due diligence phase of a deal. Parties want to review and assemble closing documents online. Deal documents can be delivered to a collaborative online workspace, allowing for better deal management, making lengthy and unruly checklists far more manageable.

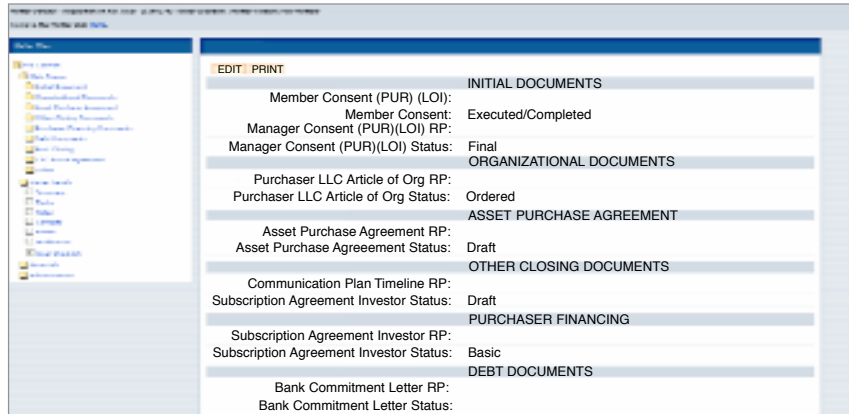
Checklists can be dynamic documents, viewable by anyone permitted. The general counsel or corporate secretary can assign a task to an individual, and then manage the deal better by tracking which documents are ready for closing. Those three-inch thick closing binders once ubiquitous on closing day can be maintained online. Saving relevant documents within a single 'closing' folder, a manager can oversee the documents more effectively.

Online environments boast several compelling advantages. In-house counsel can add notes, assign individuals tasks and flag potential problems. Collaborative work programs also facilitate a better outcome on a deal. The ultimate closing can be delayed if one party lacks, say, a necessary certificate of insurance; using an online work environment, this problem will be discovered well before closing day.

In addition, the individual running the deal can divide all documents into categories under such rubrics as debt documents, asset purchase agreements, IP doc-

## Getting organized

Here's what an online spreadsheet looks like:



	INITIAL DOCUMENTS
Member Consent (PUR) (LOI):	Executed/Completed
Member Consent (PUR)(LOI) RP:	Final
Manager Consent (PUR)(LOI) Status:	Final
Purchaser LLC Article of Org RP:	Ordered
Purchaser LLC Article of Org Status:	Ordered
ASSET PURCHASE AGREEMENT	
Asset Purchase Agreement RP:	Draft
Asset Purchase Agreement Status:	Draft
OTHER CLOSING DOCUMENTS	
Communication Plan Timeline RP:	Draft
Subscription Agreement Investor Status:	Draft
PURCHASER FINANCING	
Subscription Agreement Investor RP:	Basic
Subscription Agreement Investor Status:	Basic
DEBT DOCUMENTS	
Bank Commitment Letter RP:	
Bank Commitment Letter Status:	

Source: Corporation Service Company and LeClairRyan

uments and contracts. Online systems allow executives to run reports any time, listing outstanding documents and tasks.

### Knowing the entity

The more you know about the entity you're acquiring, the easier it is to hit the ground running.

Increasingly, companies buy divisions of companies rather than the whole enterprise. It's essential that both parties indicate which assets are included. Who owns software, licenses, patents, source code documentation, audit logs and bug reports is critical. An owner who possesses these things is better positioned to avoid past mistakes and future problems.

Another best practice is to avoid all conflicting language within documents. The more consistency across transaction documents, the lower the odds of disputes later. Consider things like what country or state law is governing the deal and what venue is being used.

With companies driving business through online channels, it's important that domain names be inventoried as they are part of an intellectual property portfolio and need to be promptly transferred. M&A attorneys are comfortable planning

for copyrights and patents but have more trouble managing domain name transfers, which are often left until after a deal has closed. Post-merger, personnel start disappearing. Often there's a special authorization code that a registry needs to unlock the domain to be transferred, problematic should the authorized individual be gone.

The acquired company must reassign all patents and copyrights, while the buyer needs to investigate what software the target company is using. If a business acquires an entity relying on open-source software, it has to consider whether it wants to continue this arrangement or make some fundamental changes.

License compliance is still a pressing issue. Some license transfers must be preapproved before a deal is complete. Fail to do so and a deal could get delayed, or worse, a critical division could be closed down until proper approvals are secured.

When negotiating a price, the buyer needs an accurate picture of the post-deal tax liability. If you don't do the math accurately, you might be taking on more costs and liability than expected. As part of analyzing the financial package, the buyer should take careful note of indemnification and insurance provisions.

## ESCAPE CLAUSES

Given dramatic reversals in the availability and cost of debt financing, many buyers have begun looking for an exit. For this reason, there is now far more attention on material adverse change (MAC) or material adverse effect (MAE) clauses and on breaches in contract.

In December 2007, a Tennessee court insisted that Finish Line should continue its acquisition of Genesco. UBS had agreed to fund the \$1.5 billion acquisition, but UBS put pressure on Finish Line to renegotiate the price or declare that an MAC/MAE had occurred when Genesco's quarterly earnings were revealed to be among the worst in the company's 10-year history. Finish Line did not prevail because of the specifics within the MAC/MAE.

Many acquisitions still contain broadly worded MAC/MAE clauses, according to a January 2008 memo by law firm Reed Smith. In the new environment, paying close attention to these clauses – even when there are no signs of trouble – simply makes good sense.

Companies need to consider remedies up front, even for deals that don't look precarious. It's important to know the termination or break-up fees before a dispute arises.

## ABA CHALLENGE

An American Bar Association (ABA) survey found that the typical US attorney uses between 20,000 and 100,000 sheets of copy paper annually. Consequently, that lawyer produces up to 4.5 tons of carbon dioxide and other greenhouse gases; that's equivalent to driving a midsize car 8,400 miles, according to an online calculator provided by Carbonify.

In March 2007 the ABA and the US Environmental Protection Agency (EPA) issued what they called the Law Office Climate Challenge. As of July 2008, the Law Office Climate Challenge had attracted 85 signatories. Participants include: the Manhattan offices of Arnold & Porter; Chadbourne & Parke; Harris Beach; Nixon Peabody; O'Melveny & Myers; Weil, Gotshal & Manges; and Paul, Weiss, Rifkind, Wharton & Garrison.

One major law firm that's signed up for the challenge and has committed to change, Sonnenschein, Nath & Rosenthal, calculated that its office uses approximately 65 million sheets annually. At this rate, the firm realizes that even a 10 percent reduction in paper used would translate into large cost savings.

# Benefits of technology

Over time, it has become increasingly clear that general counsel and corporate secretaries are central to any organization's enterprise risk management program. This is most evident in the M&A arena, where due diligence requirements touch upon every risk area from litigation to the transfer of business licenses and brand protection. There's considerable risk in any acquisition, and the general counsel and corporate secretary play a pivotal role in detecting and minimizing potential problems.

One reason online data rooms are attractive: they lower risk. When everyone's working from the same song sheet, there's less chance of miscommunication.

Online environments let companies store documents, collaborate, schedule meetings, upload checklists, and authorize users and then revoke that authorization once a party is no longer involved. Ideal for storing documents, other media can be kept there as well: videos, handwritten documents, blueprints, photos, etc.

Collaborating electronically is also far more dynamic than collaborating over paper documents. When, for instance, one party performs due diligence on a possible acquisition, that acquisition represents a snapshot of a single moment in the complex history of the company up for sale. Any events that transpire after the deal room has been assembled aren't necessarily reflected in that snapshot.

Buyers sometimes find that what happens between the due diligence process and the closing date can be critical. In the months that elapse, a company can be served with additional lawsuits, it can have a patent revoked, or some other critical event may intervene.

In other words, even though the buyer has good and thorough information on all

outstanding claims through the target company's list of pending litigation matters, things change. If new litigation matters aren't properly inventoried and communicated, large problems – or even litigation – may arise.

### Greater board participation

As more individuals are evaluating any given deal, online data rooms prove a great way to get everyone up to speed.

An online data room is one way to keep directors apprised of important, document-intensive events like mergers, acquisitions, divestitures, regulatory filings or even bankruptcy proceedings. Through the various levels of access permitted in the online data room, a company can prioritize which documents are necessary for directors to see.

Directors are spending more time than ever fulfilling their responsibilities. By

### What's the carbon footprint of a single lawyer?

The average law firm attorney uses 20,000-100,000 sheets of paper a year, according to an informal study by Arnold & Porter. At the high end of the range – 100,000 sheets of paper – the ABA calculates the environmental impact this way:

| A half-ton of paper used per attorney per year.

| From production to recycling, half a ton of paper results in 4.5 tons of carbon dioxide-equivalent greenhouse gas emissions.

| Disposal in a landfill results in an additional ton of such emissions per year.

Source: ABA (Law Office Climate Challenge)

allowing them to research M&A online in a collaborative environment, the corporate secretary can help the board perform better without requiring a burdensome outlay of additional time.

### **An international twist**

Naturally, it's important to know all the places a given company or division does business. Before buying a company with international entities, be sure to research the various rules in those countries.

Jurisdictional rules like minimum capitalization or special government approvals and transfer taxes can increase the cost of a deal by way of fines and penalties or they can force overseas operations to be shut down temporarily if necessary conditions are not met prior to closing. If the international holdings are extensive or the industry rules particularly complex, be sure to find someone on the ground you can trust for advice.

Although the hows and whys differ depending on the entity's home base, all facets of the deal take more time when there's an international component.

When trying to understand foreign entities, don't forget to look to online holdings as well. Say a company is divesting the French arm of a global enterprise. If that company sells to a competitor and doesn't specify which domain names are included in the deal, the seller might inadvertently relinquish control of some URLs central to its business.

How can a seller prevent such a scenario? By making sure to know all the assets (on the ground and online) that the target company or division possesses, and all the entities with which they're associated.

### **Going green**

Online data rooms can be a tremendous boon when companies consider the new 'triple bottom line': the economic, social and environmental impact of adopting a certain course of action.

### **Tips for reducing GHG emissions in the work place**

*To be a 'Law Office Climate Change Partner', an office has to adopt two of the following three best practices:*

- | Make sure that approximately 90 percent of all types of paper and envelopes purchased have at least 30 percent post-consumer recycled content.
- | Recycle approximately 90 percent of discarded mixed office paper.
- | Create a policy of double-sided printing and copying for drafts and internal documents.

*Source: Thomson Reuters and KPMG*

The potential cost savings from eliminating paper are impressive. If a ream of paper, 500 sheets, costs round \$2, that \$2 is just the beginning of the costs incurred. In one report, Citigroup estimates that the cost of paper storage, printing, copying, recycling, disposal and postage could make that ream of paper more than 31 times the original price.

Traditionally, M&A meant huge paper consumption. An online workspace can dramatically lower paper consumption.

Going green is more than a way to save money. Citigroup estimates, for instance, that making a single sheet of copy paper uses over 13 ounces of water. Additionally, paper production is the third most energy-intensive of all manufacturing industries.

Embracing sustainable business practices may prove an important lure for some clients who are wanting to reduce their carbon footprints.

Using online workspaces can also be a recruiting tool. Many young attorneys prefer to work at companies taking the climate issue seriously. Conceivably, a company's dedication to sustainable practices could prove an important differentiator in the not-too-distant future.

### **REINING IN COSTS**

*In the fairly recent past, most in-house counsel had virtually an open checkbook when it came to deal expenses. This is no longer the case.*

*Online data rooms can achieve real cost savings and efficiencies during the due diligence phase of a negotiation. Online workspaces obviously keep down travel costs and eliminate some of the hotel bookings for the parties researching a deal; the targeted company saves money by not renting a physical deal room, staffing the space, and providing catering and other amenities for visitors. In addition, there might be sizable FedEx or courier costs from relaying documents after parties visited the deal room.*

*Nowadays, there's unquestionably more pressure on general counsel to minimize outside counsel costs. The in-house team is accomplishing more internally and is only farming out key pieces of M&A projects when additional expertise is needed.*

*Most people agree that using online, collaborative work tools reduces the amount of time general and outside counsel have to spend reviewing documents together.*

# After the deal closes

In the midst of a deal, there's typically a fast and furious flurry of activity as both parties rush to the finish line. Once the deal has closed, the momentum slows considerably and everyone's attention shifts to the next big thing. In the post-deal slowdown, some companies fail to attend to all the necessary tasks, losing track of what needs to be accomplished and when.

Among the problems that can arise once a deal has closed is a lack of the necessary third-party approvals. Whether all real estate leases and software licenses – two matters that require third-party approvals – have been fully transferred depends upon the risk appetite of the parties involved. Often, both parties are willing to assume a modicum of risk in order to get the deal done. However, after the deal has closed, these loose ends must be satisfactorily – and quickly – resolved. In an online setting, it's easy to track which third-party approvals are out-

standing, and thus get these critical matters resolved swiftly.

Increasingly, it's a best practice for general counsel to assign a specific individual to follow up on software licenses and real estate contracts. Clarifying who is responsible for these approvals makes for a more seamless transition from frenzied deal period to post-deal aftermath.

## Second-guessing

In an unfortunate M&A trend, post-deal litigation is on the rise. At some companies, the parties squabble about the terms of the transition period. Often, working capital is set aside to make a transition run more smoothly. However, this failsafe doesn't always work. Who controls this cash – and who makes the call on how it's spent – can become a very contentious issue.

Another increasingly prevalent trend is for one party to accuse the other of serious misrepresentations during the deal.

Often, litigation hinges on which assets were included or excluded in a particular document. These types of disputes tend to arise when the buyer is purchasing a single division, rather than the whole enterprise. You can certainly anticipate far more scrutiny around what precisely is meant by a given phrase in any particular document.

Fortunately, the online data room is an ideal place for revisiting original documents and records to see precisely what was stipulated. Online workspaces record an unmistakable audit trail, specifying who reviewed which documents and on what date. Any comments made on the deal documents aren't handwritten or hastily jotted in the margins, but remain a permanent part of the online record.

Should post-deal litigation occur, both parties will inevitably go back to the documents. The online data room guarantees that the documents still exist and can be easily and reliably revisited.

## CORPORATE SECRETARY WOULD LIKE TO THANK OUR RESEARCH PARTNER

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