



M&A Lessons: In-house and Outside Counsel Perspective

Calvina Bostick, Partner, K&L Gates LLP

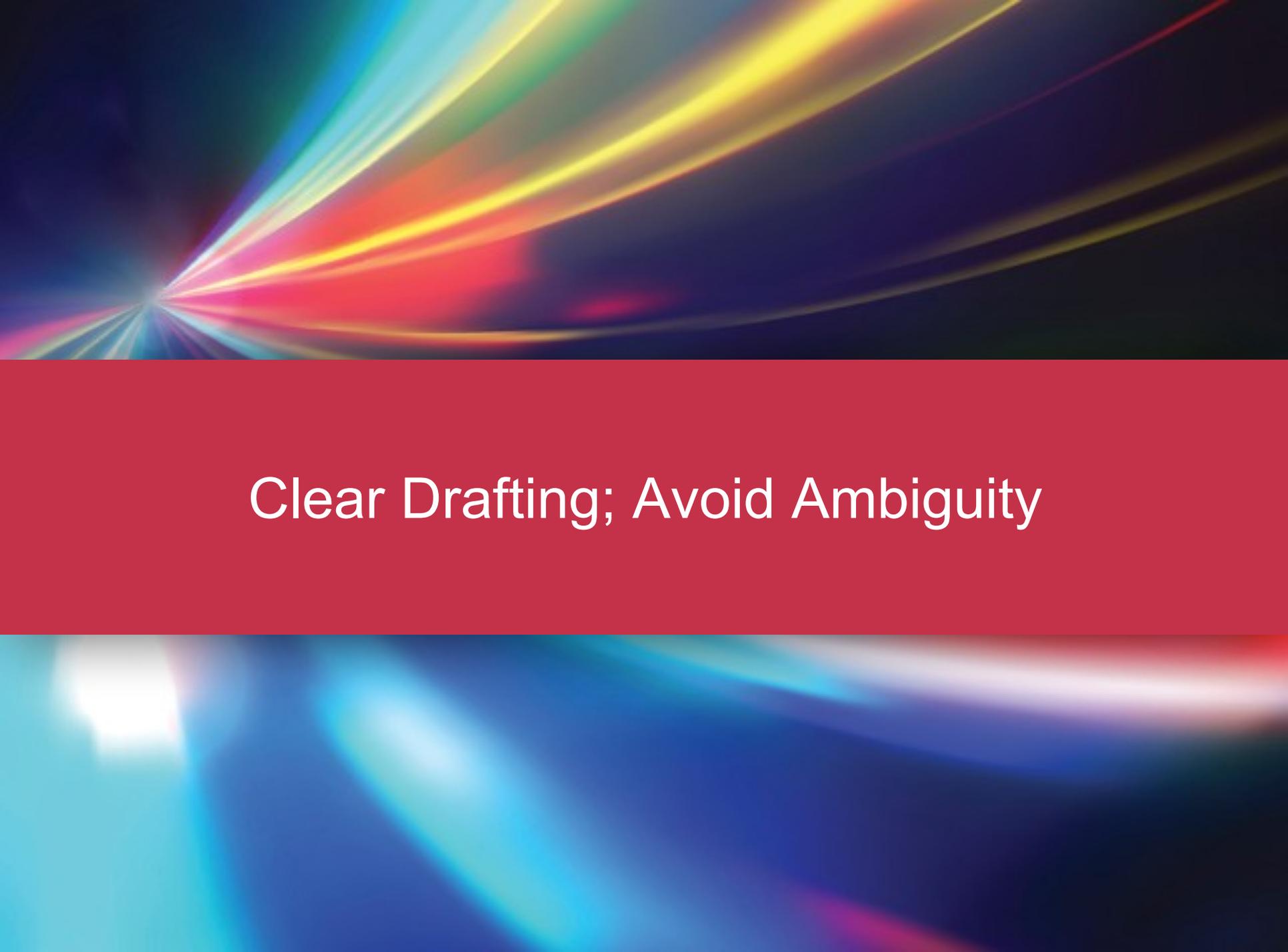
Isobel Jones, Sun Basket, Inc.

Charan Sandhu, Weil, Gotshal & Manges LLP

Amy Sellers, Walmart

Overview

1. Clear Drafting; Avoid Ambiguity
2. IP
3. Cross Border Issues
4. Indemnity Nuances
 - Duty to Defend
 - Hold Harmless
 - Limitations on Liability
 - Fraud Carve-Outs
 - Liability Disclaimers
6. Quick Hits: Advice from the Trenches (aka “Been There, Done That”)

The image features a dark background with vibrant, multi-colored light streaks radiating from the left side, transitioning through blue, green, yellow, and red. A solid red horizontal banner is positioned in the center, containing the text "Clear Drafting; Avoid Ambiguity" in white. Below the banner, the background continues with blue and cyan light streaks.

Clear Drafting; Avoid Ambiguity

Impediments to Clear Drafting

1. Ambiguity

- Contract provision is capable of conveying two or more inconsistent meanings

2. Undue generality

- Contract provision lacks detail so that it is unclear to what it applies

3. Inconsistency /Conflicts

- Contract uses word or phrase to convey two different meanings
- Contract uses two or more different words or phrases to convey the same meaning

4. Redundancy

- Contract provision includes a word or phrase that conveys a meaning expressed by one or more other words or phrases in that provision

Avoid Ambiguity

1. Company A shall sell to Distributor the Alpha Assets, excluding the Beta Assets, the Gamma Assets, and the Delta Assets.
2. Company A shall sell to Distributor (1) the Alpha Assets, excluding the Beta Assets, (2) the Gamma Assets, and (3) the Delta Assets.
3. Company A shall sell to Distributor the Alpha Assets, excluding (1) the Beta Assets, (2) the Gamma Assets, and (3) the Delta Assets.
4. Company A shall sell to Distributor the Alpha Assets (excluding the Beta Assets), the Gamma Assets, and the Delta Assets.

Avoid Ambiguity continued

1. Distributor may sell only children's drugs, medical devices, and vitamins.
2. Distributor may sell only (1) children's drugs, (2) medical devices, and (3) vitamins.
3. Distributor may sell only medical devices, vitamins, and children's drugs.
4. Distributor may sell only children's drugs, children's medical devices, and children's vitamins.
5. Distributor may sell only the following items for children: drugs, medical devices, and vitamins.

Avoid Ambiguity continued

New Jersey v. Merrill Lynch & Co.

Facts:

- Plaintiff alleged that Defendant breached a Share Exchange Agreement
- Plaintiff sued Defendant in New Jersey state court. Defendant removed the case to federal court and Plaintiff argued that the forum selection clause in the Share Exchange Agreement precluded removal to federal court.
- **The forum selection clause at issue stated, “exclusive jurisdiction...shall lie in the appropriate courts of the State [of] New Jersey”**

Holding:

- The court held that **“of”** New Jersey **limited jurisdiction to the state courts of New Jersey**, and thus the defendant contractually waived its right to remove to federal court. In contrast, **“in”** New Jersey connotes geography, and a forum selection clause containing this language would have included the federal court located in the named state. *New Jersey v. Merrill Lynch & Co.*, 640 F.3d 545 (3d Cir. 2011).

Plain English

1. Avoid archaic legalese to the extent possible
 - Recommended SEC guide: A Plain English Handbook: How to Create Clear SEC Disclosure Documents

2. Examples of simplified language

By means of

By

By reason of

Because

During such time as

While

For the purpose of

For

Owing to the fact that

Because

Two Hundred (\$200)

\$200

In the event that

If

In order to

To

In light of

Because

Subsequent to

After

Do hereby

Hereby

By and between

By

Drafting “Efforts” Standards

- Shall **sell** products
- Shall **use best efforts** to sell products
- Shall **use reasonable best efforts** to sell products
- Shall **use reasonable efforts** to sell products
- Shall **use commercially reasonable efforts** to sell products
- Shall **use commercial efforts** to sell products
- Shall **use diligent efforts** to sell products
- Shall **use good faith efforts** to sell products
- Shall **use best good faith reasonable efforts** to sell products

Drafting “Efforts” Standards (continued)

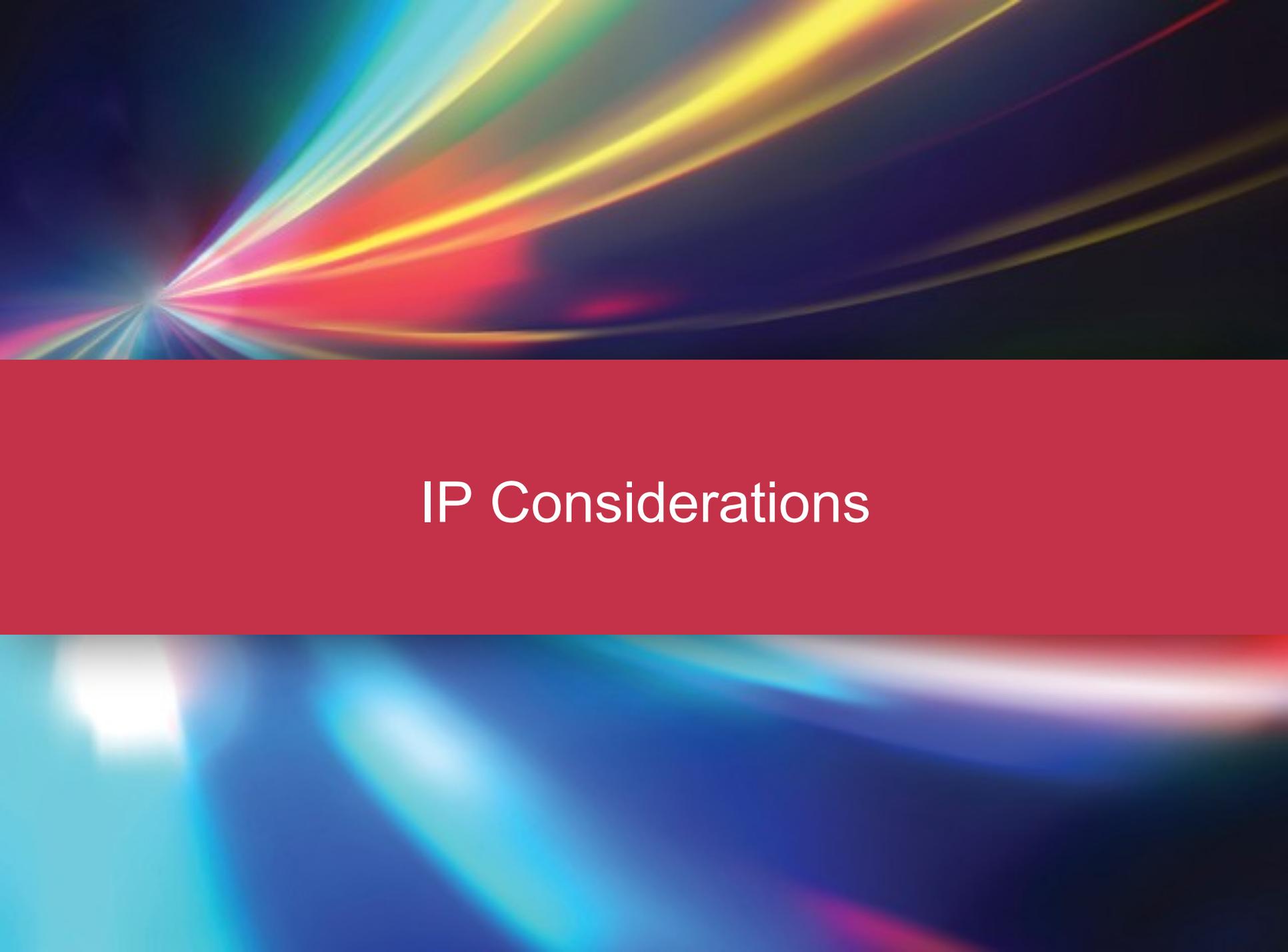
- Best provision is a requirement to accomplish a specific goal.
- Conventional wisdom among lawyers is that “**best efforts**” is the highest of the efforts standards. But best efforts likely does not include efforts that are unreasonable or extraordinary. One New York court has stated: “New York courts use the term ‘reasonable efforts’ interchangeably with ‘best efforts’”.
- **Reasonable efforts** refers to the efforts that a reasonable person would expend in the circumstances.
- **Commercially Reasonable Efforts** – Redundant as determining what constitutes reasonable efforts, in the context of a business contract, take into account commercial reasonableness.
- **Diligent Efforts** – Likely same meaning as reasonable efforts but with less clarity.
- **Good Faith Efforts** – Redundant given that an obligation to use good faith is generally implied into contracts.

Drafting “Efforts” Standards continued

Define “reasonable efforts” or “best efforts”.

Use carve-outs such as “provided however that [reasonable efforts][best efforts] do not include:

- Incurring expenses in excess of X
- Taking any actions that would, individually or in the aggregate, result in a material adverse change
- Changing business strategy
- Disposing of material assets
- Initiating litigation or arbitration
- Imperiling solvency

The background features a dark blue field with vibrant, multi-colored light streaks radiating from the left side. A solid red horizontal banner is positioned across the middle of the image, containing the text 'IP Considerations' in white. Below the banner, the background continues with more light streaks, primarily in shades of blue and cyan.

IP Considerations

Forms of Intellectual Property

- Copyrights
- Trademarks
- Patents
- Trade Secrets

Ownership of Intellectual Property

- There must be clarity between the parties as to ownership of pre-existing intellectual property (“IP”) of the parties, and any IP developed under or in connection with the Agreement.
 - Who will own any modifications which are made to pre-existing IP?
- Always include *present* assignment language of IP.

IP Assignments

Case Study: Board of Trustees of the Leland Stanford Junior University v. Roche Molecular Systems, Inc. 563 U.S._____ (2011)

- Stanford wrongly believed that it had been assigned rights to patents for a PCR-based procedure to measure the amount of HIV in blood.
- The procedure was developed by an inventor hired by Stanford who then went to Cetus to conduct his research.
- Cetus was later acquired by Roche Molecular Systems, Inc.
- Agreement with Stanford stated the he “agree[d] to assign” Stanford his “right, title and interest in” inventions resulting from his employment at the University.

IP Assignments (continued)

Case Study: Board of Trustees of the Leland Stanford Junior University v. Roche Molecular Systems, Inc. 563 U.S._____ (2011)

- Agreement with Cetus stated that he “**will assign and do[es] hereby assign**” to Cetus “his right, title and interest in each of the ideas, inventions and improvements” made “as a consequence of [his] access” to Cetus.
- The Court found that the inventor’s initial agreement with Stanford “**constituted a mere promise to assign rights in the future**” while the agreement with Cetus was effective because it “**itself assigned [the inventor’s] rights in the invention.**”
- Based on this finding, the Court ruled that it was Roche and not Stanford that “possesse[d] an ownership interest in the patents-in-suit.”
- Drafting lesson also pertains to grants if IP licenses.

IP Assignments – Example (continued)

Drafting Example:

“The Manufacturer **hereby irrevocably assigns** to the Purchaser all worldwide rights, title and interest in, to, and under (i) all Purchaser Designs, materials, and other works provided by Purchaser to Manufacturer hereunder (subject to any pre-existing third party rights therein or thereto), and (ii) all materials and/or works created, developed, or modified by the Manufacturer for Purchaser in connection with the Products (collectively, “Work Product”). Manufacturer agrees that, as between Manufacturer and Purchaser, the Purchaser shall be the sole and exclusive owner of the Work Product, and shall cause its personnel to enter into valid and enforceable written agreements **irrevocably assigning** to Purchaser, any and all rights, title and interest throughout the world in and to all Work Product.”

IP Clauses — Identification of Relevant Law

1. Licensor has complied with all laws applicable to the Business and the Licensed IP.
2. Licensor has complied with all laws applicable to the Business and all laws applicable to the Licensed IP.
3. Licensor has complied with all laws applicable to both the Business and the Licensed IP.

IP Clauses — Infringement, Representations and Warranties

1. Licensor represents that there are no claims pending or threatened to the Knowledge of Licensor.
2. To the Knowledge of Licensor, Licensor represents that there are no claims pending or threatened.
3. Licensor represents that there are no claims pending or, to the Knowledge of Licensor threatened.

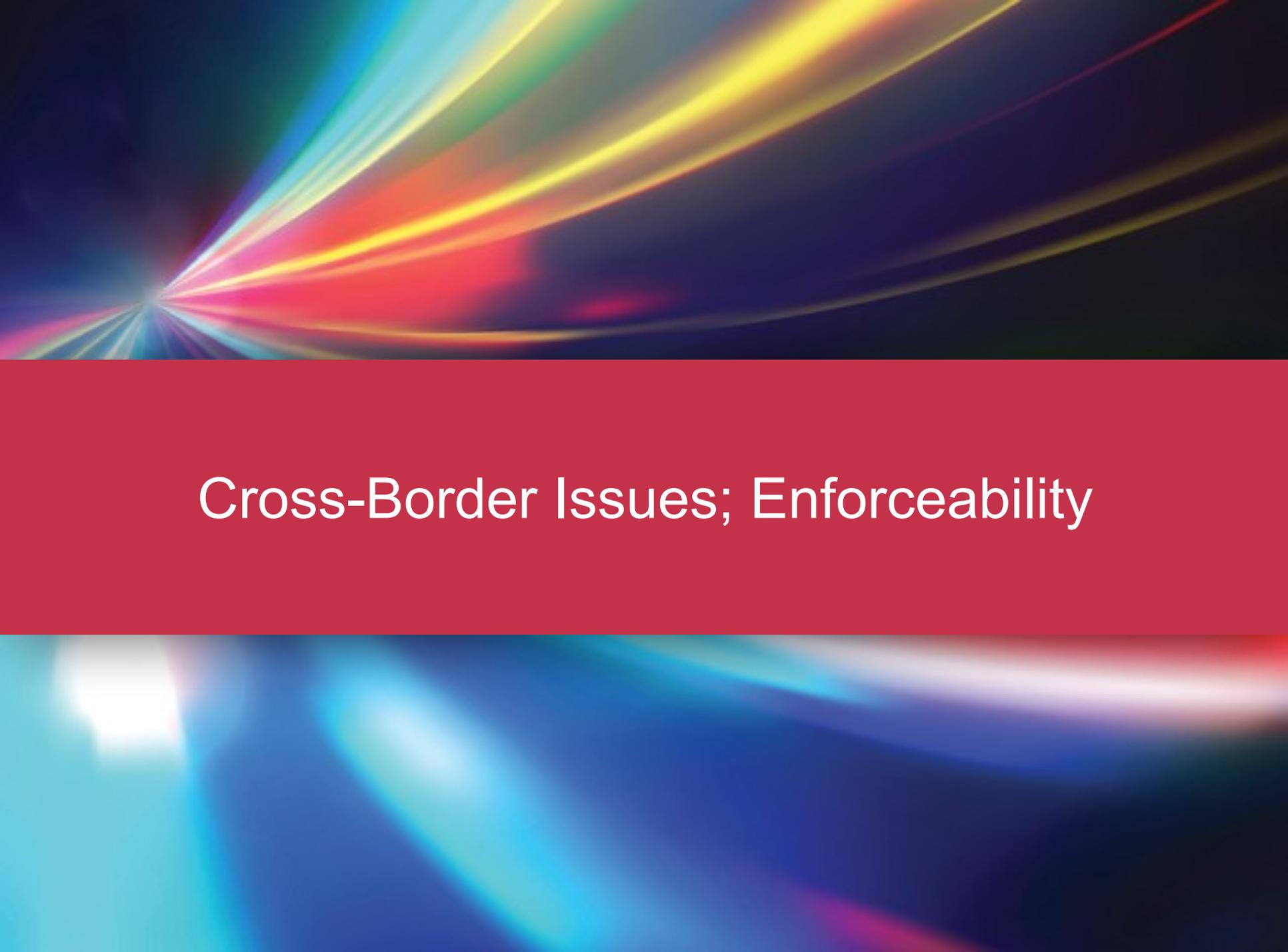
IP Clauses — Overlap with Confidentiality

Review Confidentiality Clause for IP Restrictions:

“Company Confidential Information means all information of Company or any of its Affiliates. The Receiving Party shall *maintain the confidentiality* of all Company Confidential Information and *shall only use* Company Confidential Information for the purposes set forth in this Agreement. Notwithstanding the foregoing, *the Receiving Party will not be prohibited from using* information that is publicly available, that is independently developed without use of Company Confidential Information, or is received from a party that has no duty to maintain the confidentiality of the information.”

Licenses

- Field
- Term
- Assignment and change of control
- Sublicensing
- Royalties
- Territory
- Exclusivity
- Control Over IP (Prosecution/Maintenance/Enforcement)
- For Trademark Licenses, Quality Control

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Cross-Border Issues; Enforceability

Company May Not Own Its IP Due to Local Idiosyncrasies

Limitations on What Can Be Assigned and Formal Requirements for Assignment

- **Europe/Hong Kong/Japan/Taiwan:** There are limitations on the assignment of moral rights, including the right to list oneself as “author.”
- **Malaysia:** A separate deed of assignment should be executed during employment for assignment of patents and industrial designs.
- **Philippines:** It is recommended that IP agreements be notarized to help the company show that the employee freely signed the agreement.

Company May Not Own Its IP Due to Local Idiosyncrasies

Assignments of IP Rendered Invalid if Local Requirements Not Complied With

- **Germany:** Under the German Act on Employee Inventions, once the employee has made an invention, the employee must notify the employer, at which point the employer automatically becomes the owner of the invention if it does not oppose such a transfer. Remuneration is required for the transfer.
 - An invention made by an employee but not created during the course of the employee's work assignment is called a "free" invention. In these cases, the employee must still notify the employer, who will have a limited time to challenge the classification of the invention as free. The employee must still, however, offer the invention for the employer's use.

Company May Not Own Its IP Due to Local Idiosyncrasies

Assignments of IP Invalid (cont'd)

- **China:** Under the Implementing Regulations of the Patent Law, inventors are entitled to a lump sum payment when the patent right is granted of no less than RMB 3,000 (roughly \$450) for invention patents, no less than RMB 1,000 (roughly \$150) for utility models or design patents, remuneration when the patent is exploited, including at least 10% of the license fee if a patent is licensed to third parties, and either (1) a percentage of the after-tax income derived from the exploitation of the invention each year, or (2) a one-time award of equivalent value.
 - Employers are expressly permitted to contract out of this scheme, however.
 - Thus, it is recommended that Chinese companies set up an inventor's award scheme as a broad policy for their entire workforce.

Failure to Follow Local IP Requirements Can Destroy IP Value

In various EU countries, failure to record a patent/trademark assignment on acquisition of IP within 6 months of the transfer can render the IP unenforceable and prevent the new owner from recovering damages for infringement.

Plethora of Requirements for IP in PRC

Unusual Requirements for Licenses and Technology Transfer Agreements

- Ownership of Improvements must be by PRC Licensee
- Technology Import Agreements cannot contain restrictive provisions, e.g. the following restrictions are prohibited:
 - Licensee must accept terms not indispensable to importing the technology,
 - Licensee may not improve the technology or other limitations on the licensee's use of improved technology,
 - Licensee may not acquire technology similar to or which competes with technology provided by the licensor, and
 - Licensee must share or transfer improvements without compensation.

Plethora of Requirements for IP in PRC

Particular Requirements for IP in PRC Joint Ventures

- Limitations on contributions of IP toward registered capital
- The use of intellectual property and other intangible properties as the contribution of the registered capital of a Chinese company (including JVs) is generally allowed.
- However, Chinese authorities generally won't permit IP to be contributed to a JV via a license, even if the license is exclusive.
 - The overriding rationale is that the registered capital of Chinese Companies should be fully and independently owned by such companies.
 - In order to be considered a valid registered capital contribution, an asset must be one that the JV can fully own, exploit and dispose of without undue restrictions.

Plethora of Requirements for IP in PRC

Particular Requirements for IP in PRC Joint Ventures

- Difficulties ensue over the fact that Chinese regulatory authorities have discretion as to what does or does not qualify as an undue restriction.
- Certain contributions that raise concern:
 - Express reservation of rights (i.e., assigning the IP to the JV solely to the extent necessary to operate the company's business, but otherwise retaining the assignor's rights to the IP to use in areas outside the company's business),
 - Exclusive license back to the assignor of the assigned IP that prohibits the company from using the IP in areas other the company's specific business, or
 - Express restriction on the further assignment or use of the IP by the JV company.

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Indemnification

INDEMNIFICATION: The Basics

- Reasons for including an indemnification clause:
 - Privity of Contract: Some or all of the indemnifying/indemnified parties may not be a party to the agreement
 - In an acquisition agreement, consideration may be paid to a large number of equity holders and it may be impractical to recover damages from each
 - Reliance: To recover for breach of a representation, a party may have to prove reliance
 - Prior Knowledge: A party may not be able to recover damages for a breach of a representation if it had prior knowledge of such breach

INDEMNIFICATION: Duty to Indemnify vs: Duty to Defend

- The obligation to defend requires a party to defend or fund the defense of a claim at the outset
 - Duty to defend is broader than, and arises more often than, the duty to provide indemnity for a loss or judgment.

See, e.g., Hollingsworth v. Chrysler Corp., 58 Del. 236 (1965).

- In a minority of jurisdictions (such as California), an indemnifying party always has an obligation to defend

INDEMNIFICATION: Duty to Indemnify vs. Hold Harmless

Indemnify and “hold harmless” are often used interchangeably.

- Many courts have found that the terms are synonymous.
- However, some courts have found that “hold harmless” only releases the indemnitee from liability to the indemnified party
 - See Exxon Mobil Corp. v. New W. Petroleum, LP, 369 F. Supp. 2d (N.S. Cal. 2009)
 - Under this interpretation, an obligation to “hold harmless’ would only cover direct claims from the indemnified party (not third-party claims)

INDEMNIFICATION: Limitations on Liability

Limitations on Damages

- Distinctions between types damages is a complex subject with numerous subtleties and lack of clear case law
- **Example:** Seller shall not be liable for “consequential, incidental, indirect, special or punitive damages, including any loss of future revenue, income or profits or any diminution of value”

INDEMNIFICATION: Limitations on Liability

- What is a party giving up?
 - Punitive damages are tort-based and intended to punish particularly egregious conduct, not to compensate a non-breaching party
 - Contract damages on the other hand generally include (i) those damages that arise normally and naturally as a result of a breach and (ii) other losses arising from the special circumstances of the non-breaching party to the extent such special circumstances were within the contemplation of the parties as a probable consequence of a breach

INDEMNIFICATION: Limitations on Liability

Consequential Damages

- Definitions vary:
 - “Such damage, loss, or injury as does not flow directly and immediately from the act of the party, but only from the consequences or results of such act.”
 - “Damages which arise from special circumstances that make them probable, although they would be unusual apart from such circumstances.”
- Key: Consequential damages are not (1) unforeseeable, (2) all lost profits or (3) incidental damages

INDEMNIFICATION: Limitations on Liability

Lost Profits

Some lost profits are consequential damages:

- Profits buyer anticipated from the sale of goods that seller failed to deliver under a contract
- Profits buyer anticipated from operating a factory using tools that seller failed to deliver under a contract

Some lost profits are direct damages:

- Profits seller anticipated from the purchase price that the buyer failed to pay under a contract.
 - These profits are direct and probable consequence of breach and would be suffered by any seller in similar circumstances.

INDEMNIFICATION: Buyer beware of indemnification obligations to Sellers

- **Case Study: Davis v. EMSI Holding Co., C.A. No. 12854-VCS (Del. Ch. May 3, 2017)**
 - Sellers that were officers or directors of the Target entity pre-closing may be entitled to indemnification from the Target for actions they took pre-closing in their role as officers or directors
 - Buyers must be aware of this loophole and take protective steps to ensure that sellers that held these positions remain liable for their post-closing indemnification obligations

INDEMNIFICATION: Fraud Carve-Outs

- **Case Study: EMSI Acquisition Inc. v. Contrarian Funds LLC, C.A. No. 12648 (Del.Ch. May 3, 2017)**
 - Most agreements exclude fraud from limitations of liability or exclusivity of legal remedies
 - As demonstrated by the *EMSI* case, the failure to define the fraud carve-out can have unintended consequences for the indemnifying party, including uncapped liability based on the actions on management for which the sellers were unaware
 - Fraud is an ambiguous term derived from common law and courts of equity; therefore, it should be defined when used as an exception to a limitation of liability or exclusive remedy provision (such as deliberate misrepresentation *by the seller*).

INDEMNIFICATION: Disclaimers of Reliance

- Purchase agreements often contain a disclaimer by the seller of extra-contractual representations and warranties. At the same time, purchase agreements often obtain a fraud carve-out stating that various seller protections do not apply in cases of fraud.
 - Will a disclaimer of extra-contractual reps and warranties bar fraud claims in Delaware?
 - AC Search, LLC v. Conversant LLC, 2016 WL 6995363 (Del. Ch. Nov. 30, 2016)
 - The court explained that, in order to bar fraud claims, a disclaimer of reliance must come from the point of view of the aggrieved party. An assertion from the seller ‘of what it was and was not representing and warranting’ is not sufficient given the law’s abhorrence of fraud.”
- An integration clause, which states that all representations or warranties relating to the transaction are contained in the agreement, will not preclude a common-law fraud claim; the agreement must contain an affirmative disclaimer of reliance from the aggrieved party (FdG Logistics LLC v. A&R Logistics Holdings, Inc., 131 A.3d 842, 860 (Del. Ch. 2016)).

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Quick Hits: Advice from the Trenches

Be Prepared

All Companies:

- **Have a “Data Room” or other repository for contracts, etc:** Pulling this information together when a deal has started costs time and can create “noise”
 - Good governance/good internal controls help
- **Understand how your company fits into the M&A landscape:** Are you a likely Acquiror? Target? For a strategic? Other?
 - Who do you need to get a deal signed? Keep wheels on the bus while deal is pending?
- **Consider/benchmark your severance plan(s):** Making changes “in contemplation” of transaction can be harder and less beneficial

Public Companies:

- **Have formulas for calculating payments upon Change of Control:** Use your work for the potential payments section of your annual proxy statement to give you a head start
 - When can you get this section of the proxy statement to us?....
- **Train:** Insider trading training needs to be more than just understanding blackout periods under your trading policy
 - How could I possibly get caught?.... TELL THEM
 - Training might also be important if a public company is on other side

Pre-Deal Considerations

A. Understand the principal purpose of the transaction:

- Acquire Specific Assets
- Target NOLS

B. Structural Considerations

- Difficulty obtaining stockholder approval
- Assignability of contracts
- Possible concern about Target liabilities
- Possible need for government approvals (i.e., Hart Scott Rodino Act filing)
- Tax considerations

C. Letter of Intent

- An LOI contains principal terms of the transaction, such as price, structure, material closing conditions and indemnification

Keep Good Records/Notes

Particularly if a Public Company is Involved

- **Track contacts/interactions between the companies:** Pulling this information together accurately after the fact is excruciatingly painful...
 - Background of the Proposed Merger portion of deal proxy statement
 - Many conversations never lead to anything, but it never hurts to start early
- **Track when team members come “under the tent” and ensure your service providers are doing same:** Information may be needed to respond to FINRA, NYSE or Nasdaq inquiry
 - Who knew and when....?
 - Make sure deal team understands from outset that this has to be tracked

All Companies:

- **Segregate your deal-related work from other privileged documents:** Think about paper files, computer files, email, etc.

Leverage Your Bankers

Establishing a good working relationship with the bankers can make your life easier

- **Strategy:** Coordinate with lead banker
- **Logistics:** Let them set up diligence calls; have them also track material communications/discussions
- **Data Room:** Let them load dox, especially if multiple bidders

Negotiating the Deal

Be Smart about Pre-Closing Covenants

- ***Make sure consent levels let you operate in ordinary course/avoid “accidental footfalls”:*** Of all legal advisors involved, you understand your business best
 - How much is a boatload of tuna...?
- ***Build in known/expected exceptions via disclosure schedule:*** May be easier to get OK while negotiating deal
 - How are you going to deal w/ promised but unissued equity? Outstanding job offers?
 - Do you need a bonus pool to keep the wheels on the bus?
- ***Communicate covenants to team:*** Make sure the right internal folks know what they can and can't do; establish a process for seeking consents with your counterpart
 - Good governance/good internal controls help

Negotiating the Deal

Deal with Privilege/Information Relating to Transaction

- ***Merger Agreement should deal with “ownership of privilege”:*** Delaware issue, Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP
 - Don't forget to transfer files to counsel for possession
- ***Reminder that the company owns/controls the data room:*** Decide how data room will be preserved so sellers/seller representative will be able to show what was shared if necessary

Understand 280G – Quick Recap

280G applies to compensation (broadly defined)

- ***Paid to any “disqualified individual”:*** Officers, stockholders and “highly compensated individuals”
 - Highly compensated = lesser of 250 people or top 1% of company, provided salary is at least \$115K
- ***Contingent on a change in control:*** Arrangements put in place within 1 year of change in control are presumed to be contingent
 - Does entire value of stock acceleration get counted? Or just the time value?
- ***Equals or exceeds 3x average annual compensation:*** Average annual compensation often referred to as the “base amount”
 - Usually average based on five years preceding the year of change in control
 - Based on taxable compensation – so 401(k) contributions will decrease and certain equity exercises will increase

Understand 280G – Quick Recap (cont.)

A. Any amount that is more than 1x base amount = excess parachute payment

- **Company loses deduction:** Normally compensation payments are deductible for tax purposes; excess parachute payments are not
- **Recipient pays 20% excise tax:** Excise tax is in addition to standard income and payroll taxes
 - Many agreements have “cut back” clauses

B. Private companies can avoid with 75% approval of disinterested shareholders

So, for public companies and their employees, is there nothing that can be done?

Understand 280G

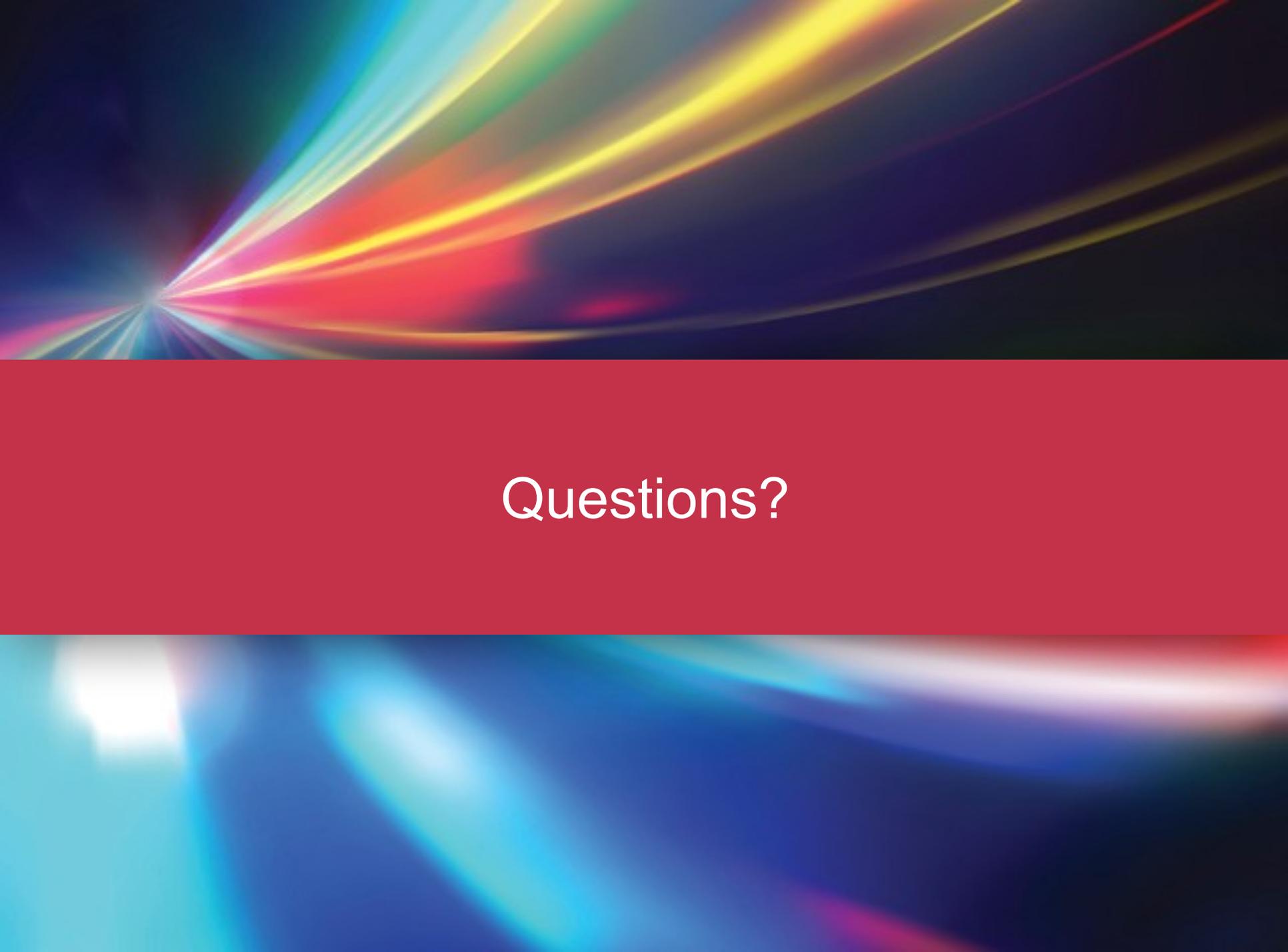
Particularly Important if Deal will Close Next Tax Year

- **Engage experts:** Complicated with lots of number crunching, especially if value of compensation moves w/ stock price of acquiror
- **Identify 280G Issues ASAP:** If anyone is at risk of having an excess parachute payment, action can be taken in current tax year to increase the base amount
 - Employees can exercise stock (if they want)
 - Company can accelerate stock early; value still gets counted against 3x limit, but will increase base amount
- **Get valuation of non-compete:** Will work only for most senior business leaders

Update Your Resume

Synergy Savings

- ***Effective Resumes include Objective, Measurable Accomplishments:***
Easier to do when you still have your calendar and files

The image features a dark background with vibrant, multi-colored light streaks radiating from the left side, transitioning through blue, green, yellow, and red. A solid red horizontal band spans the middle of the image, containing the text "Questions?".

Questions?



Thank you

