What's the Market for that Cross-Border Deal? The European, US and Canadian Private Target M&A Deal Points Studies

John F Clifford, Freek Jonkhart and Jessica Pearlman*

When negotiating their asset or stock purchase agreement, buyers and sellers often get to an impasse on a deal point and want to know: 'What's market?' Determining what is 'market' can be difficult in domestic deals and sometimes impossible in cross-border or global deals. Investment bankers and other sources for years have compiled market metric data to address this question but such data was often likely to be skewed by inherent institutional bias by representing only the deals with which that source had been involved. Deal lawyers lacked a reliable, independent source.

This information gap started closing in 2006 when the M&A Market Trends Subcommittee (the 'Subcommittee') of the American Bar Association's Section of Business Law's M&A Committee published its first deal points study. This study surveyed and reported the frequency of use of various deal terms in agreements in which US public companies acquired private companies in

* John Clifford is a partner in the Toronto office of McMillan LLP, where he focuses his practice on merger and acquisition transactions. John is a member of the M&A Market Trends Subcommittee of the M&A Committee of the American Bar Association's Section of Business Law and chaired the ABA's 2010 and 2008 Canadian Private Target M&A Deal Points Study groups. Freek Jonkhart is a partner of Loyens & Loeff NV. Based in Rotterdam, he is a member of the firm's corporate law practice group. Freek is a member of the M&A Market Trends Subcommittee of the M&A Committee of the American Bar Association's Section of Business Law and co-chaired the ABA's 2010 and 2008 European Private Target M&A Deal Points Studies. Jessica Pearlman is a partner in the Seattle office of K&L Gates LLP, where she represents emerging and established companies in various corporate, securities and finance matters, with an emphasis on mergers and acquisitions. Jessica is co-chair of the M&A Market Trends Subcommittee of the M&A Committee of the American Bar Association's Section of Business Law.

transactions material enough to the acquirers to require public filing of the purchase agreement. For the US, the Subcommittee has since published updates of the US private target study as well as studies reporting deal points in both US private equity buyer/public target and US strategic buyer/public target deals.

The Subcommittee made comparative international data available in 2008 when it released both a Canadian private target study and a European private target study.

The Subcommittee released its most recent US Private Target M&A Deal Points Study (the 'US Study') in December 2009. Subsequently, it released its most recent European Private Target M&A Deal Points Study (the 'European Study') in August 2010 and its most recent Canadian Private Target M&A Deal Points Study (the 'Canadian Study') in December 2010.

These studies provide a wealth of helpful nuggets and useful data points for the deal lawyer, including (in the case of the European and Canadian studies) many pages comparing the results of the studies with the US Study, making the European Study and Canadian Study a useful resource for deal lawyers involved in cross-border transactions. Points of particular interest from the three studies are discussed below.

Study samples and methodologies

US Study

The US Study analysed 106 acquisition agreements for transactions completed in 2008 that involved private targets being acquired by US public companies in transactions material enough to those US public companies for such agreements to be required to be filed publicly on EDGAR (the US Securities and Exchange Commission's 'Electronic Data Gathering Analysis and Retrieval' system). This study sample excluded agreements for deals having a transaction size of less than US$25 million or more than US$500 million, agreements for transactions in which the target was in bankruptcy, reverse mergers and transactions otherwise deemed inappropriate for inclusion.

A team of 68 experienced deal lawyers, from various jurisdictions and from a variety of different sizes of law firm, reviewed in detail the agreements underlying the US Study and identified the frequency of use of deal terms such as financial provisions, pervasive qualifiers, representations and warranties, conditions to closing, indemnification and dispute resolution, in many instances comparing the negotiated provision with comparable provisions in the ABA's Model Stock Purchase Agreement or Model Asset Purchase Agreement. Each individual's work was checked at several levels to ensure consistent quality and interpretation of results.

Canadian Study

The methodology underlying the Canadian Study was quite similar to the US Study. The Canadian Study analysed 62 share and asset purchase agreements publicly available only on SEDAR (the Ontario Security Commission's 'System of Electronic Document and Analysis') by public companies for their acquisition of private companies, for deals that closed in 2007, 2008 and 2009. Similar to the US Study, this final study sample excluded agreements for deals having a transaction size of less than C$5 million, transactions involving non-arm's length parties, transactions not governed by Canadian law and transactions otherwise deemed inappropriate for inclusion.

Deal lawyers from across Canada reviewed in detail the agreements underlying the Canadian Study. To maximise the utility of the Canadian Study for US–Canada cross-border transactions, the Canadian Study identified and reported the frequency of use of the same deal terms reported in the US Study. And, in a process similar to that used for the US Study, the work product of each individual who contributed to the Canadian Study was checked at several levels to ensure consistent quality and interpretation of results.

European Study

In Europe, there is no publicly available depository for acquisition agreements. So, lawyers from law firms in Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Norway, Spain, Sweden, Switzerland, Turkey and the United Kingdom involved in the study working group identified share purchase agreements negotiated on behalf of their own clients that could be relevant for the European Study and provided data by means of questionnaire responses (with no communication of confidential client data). Validity and consistency of data were verified by a combination of telephone interviews with the 27 working group members and a review of numerous 'sanitised' agreements or excerpts from those agreements.

The final European Study reported the frequency of use of various deal terms in 97 share purchase agreements, all of which were for deals that closed in 2008 and with a value in excess of €25 million. That study covers many of the topics reported in the US Study and the Canadian Study.

Table 1: Study samples

	Canadian Study	European Study	US Study
When deals closed	2007, 2008, 2009	2008	2008
Number of deals	62	97	106
Three principal industries	– Chemicals/natural resources – Oil and gas – Industrial goods	– Industrial goods and services – Consumer goods – Technology	– Technology – Industrial goods and services – Health care
Deal sizes	C$5M and higher (3 deals were > C$500M)	€25M–€805M	US$25M–US$500M
Indicative range of deal sizes	60% of deals were C$5M–C$100M	56% of deals were €25M–€100M	68% of deals were US$25M–US$100M

Points of interest

This article summarises below 12 particularly interesting findings reported in the studies, and makes comparisons with the findings of each study. Of course, these points are just a few of the many helpful data points contained in the studies, so the authors encourage you to review the studies in their entirety.

Approaches to purchase price adjustments differ across jurisdictions

The US Study reported that the negotiated purchase price was adjusted after closing in 79 per cent of the deals surveyed. Working capital was the most commonly used metric to determine the purchase price post-closing and, potentially, make adjustments (in 77 per cent of deals surveyed that provided for such adjustments).

Post-closing adjustments are provided for less frequently in the surveyed European and Canadian deals. The European Study and Canadian Study reported that a mechanism for adjusting the purchase price after closing was provided for in only 49 per cent and 50 per cent of the surveyed deals, respectively.

As in the US Study, however, in surveyed agreements that provided for purchase price adjustments, working capital is the most commonly used

metric in both the European Study (46 per cent) and the Canadian Study (77 per cent). But in the European Study net asset value was used as an adjustment metric in almost the same number of those deals (42 per cent), quite different from the US Study and the Canadian Study, which reported net asset value (NAV) as a metric to adjust the purchase price in only six per cent and three per cent, respectively, of the deals surveyed that provided for post-closing adjustments.

It is also notable that the Canadian Study reported that, of the surveyed deals that contemplated post-closing purchase price adjustments, the buyer prepared the first draft of the closing date financial statements in only 29 per cent of the deals. Sellers prepared the first draft in 58 per cent of those deals. The US practice seems to be much different: the US Study reported that the seller prepared the first draft of the closing date balance sheet in 83 per cent of the deals surveyed with post-closing purchase price adjustments. (This point was not reported on in the European Study.)

Earns-outs, while not dominant anywhere, are most common in the United States

According to the US Study, earn-outs were a feature in 29 per cent of the deals surveyed for that study. The situation is quite different elsewhere: the European Study reported that the purchase price was paid (in whole or part) by way of an earn-out in only 11 per cent of deals surveyed. Earn-outs are much rarer in the Canadian Study, where a mere three per cent of the deals surveyed included an earn-out. It will be interesting to see if earn-outs have become more prevalent in a down market as a way of bridging gaps between sellers' expectations of value and what buyers are willing to pay.

'Material adverse effect' pervasive qualifiers are prevalent

Perhaps reflecting a convergence of Canadian, European and US deal practice, pervasive qualifiers based on material adverse effects (MAEs) are common in all jurisdictions. According to the Canadian Study, 'material adverse effect' (or a similar term) was included in 91 per cent of the deals surveyed, and 73 per cent of the deals included a specific definition of the term. The defined term was forward-looking in 69 per cent of Canadian deals surveyed and included a reference to the target's 'prospects' in 40 per cent of those deals. As noted in the Table 2, similar trends were reported in the US Study and the European Study, although the term 'material adverse effect' is expressly defined less frequently in the surveyed European deals.

Table 2: Pervasive qualifiers – material adverse effect

	Canadian Study	European Study	US Study
Defined term included	73% of deals	38% of deals	92% of deals
– 'prospects' included	40% of deals with defined term	47% of deals with defined term	38% of deals with defined term
– standard is forward looking	69% of deals with defined term	Not reported	74% of deals with defined term

One interesting note is that financial market downturns were specifically carved out from the MAE definition in 70 per cent of the surveyed Canadian deals that had the defined term, yet was carved out in only 49 per cent of the surveyed US deals with carve-outs to the defined term. (This point was not reported on in the European Study.) This may be due to the fact that while the Canadian Study includes a large number of deals that closed in 2007, the US Study covers deals that closed in 2008, a time when financial markets were declining, and the parties may have wanted to ensure their deals closed notwithstanding those general market conditions.

It also is notable that in Europe only 47 per cent of deals surveyed included an express condition of closing that a material adverse change (MAC) shall not have occurred. This is markedly different from the US and Canada; of deals that did not sign and close simultaneously, a MAC condition was included in 98 per cent of such deals surveyed for the US Study and in 85 per cent of such deals surveyed for the Canadian Study.

Europeans are less likely to require (or provide) a 'no undisclosed liabilities' rep

Almost every acquisition agreement reviewed for the US Study included a representation to the effect that the seller was not aware of any liabilities of the target other than liabilities disclosed or reserved against in the target's financial statements, incurred by the target in the ordinary course of business. Canadians included the representation in a large majority of deals surveyed for the Canadian Study. But, according to the European Study, a 'no undisclosed liabilities' representation is made only 40 per cent of the time in European deals. It may be that Europeans more often rely solely on the financial statements of the target (prepared in accordance with applicable GAAP) to ascertain the liabilities of the target.

Figure 1: Canadian Study – 'no undisclosed liabilities' rep

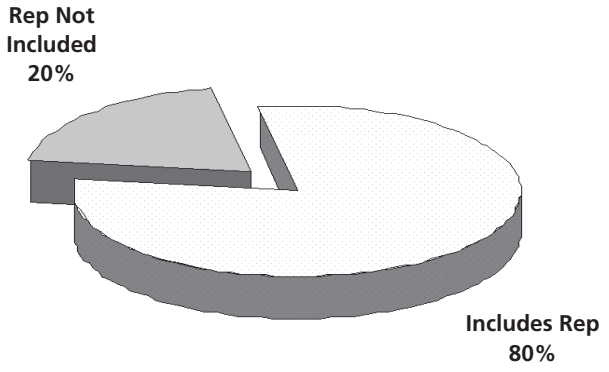


Figure 2: European Study – 'no undisclosed liabilities' rep

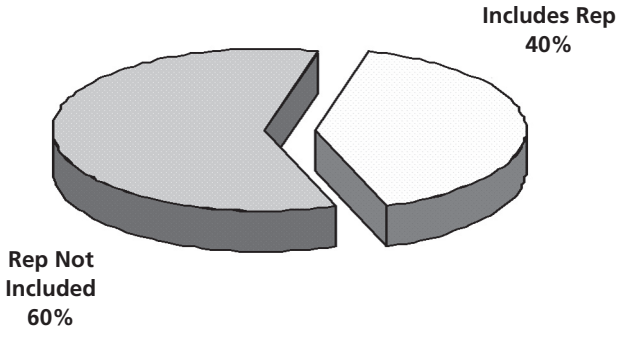
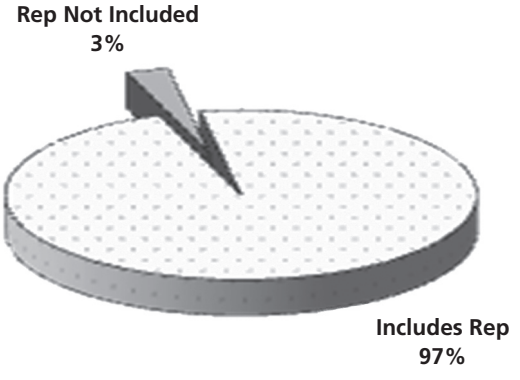


Figure 3: US Study – 'no undisclosed liabilities' rep



However, when the representation is included in an acquisition agreement, it is not often qualified by knowledge in any of the covered jurisdictions. (The 'no undisclosed liabilities' representation was knowledge-qualified in only five per cent of surveyed US deals with the representation, 15 per cent of surveyed European deals with the representation and 16 per cent of surveyed Canadian deals with the representation.)

North American buyers want to know the seller has disclosed what it knows

The US Study reported that 68 per cent of the deals surveyed included some formulation of a representation from the seller to the effect that none of its representations or warranties in the acquisition agreement contained any untrue statement of material fact or failed to disclose a material fact necessary to make its representations or disclosures not misleading. In 58 per cent of US deals surveyed, the representation was a '10b-5' formulation (ie it tracked the language of the US Securities and Exchange Commission's Rule 10b-5); in ten per cent of the deals the representation was the broader 'full disclosure' formulation, either alone or in combination with a 10b-5 formulation. Interestingly, the representation was qualified by knowledge of the seller in 90 per cent of those agreements that included both a 10b-5 and a 'full disclosure' formulation of the representation, whereas the representation was knowledge-qualified in only 13 per cent of surveyed deals that provided just a 10b-5 formulation of the representation.

This is more than in the Canadian Study, where 56 per cent of deals surveyed included some form of 'full disclosure' representation. (The Canadian Study did not report on 10b-5 formulations of the representation since the Securities and Exchange Commission Rule underlying that formulation is a feature of US law.) And, interestingly, the full disclosure representation was qualified by knowledge in 37 per cent of those Canadian deals.

The trend in Europe is slightly different. According to the European Study, only 46 per cent of deals surveyed contained a form of full disclosure representation, and the representation was knowledge-qualified in 60 per cent of those deals. (Like the Canadian Study, the European Study did not report on 10b-5 formulations of the representation.)

Americans often 'scrape' away double materiality provisions

Representations and warranties in acquisition agreements are often qualified by materiality to ensure insignificant inaccuracies in a representation or warranty do not give rise to post-closing indemnity claims. (For example,

an agreement might include a representation to the effect that the target has complied 'in all material respects' with contracts to which it is bound.)

For deals that do not close on the date the acquisition agreement is signed, the acquisition agreement typically also includes a 'bring-down' condition to closing to the effect that all representations and warranties of the seller are true and correct on the closing date as if made on that date. Savvy sellers often seek to include a materiality qualifier in the condition – so that it requires, for example, that all representations and warranties of the seller are true and correct 'in all material respects' on the closing date as if made on that date – to prevent giving remorseful buyers an excuse to not close the transaction because of a non-material inaccuracy in the representations. But if both the representation and the condition are qualified by materiality, the parties have created a double layer of materiality for the representation, perhaps unwittingly.

Figure 4: Canadian Study: accuracy of reps: 'bring-down'

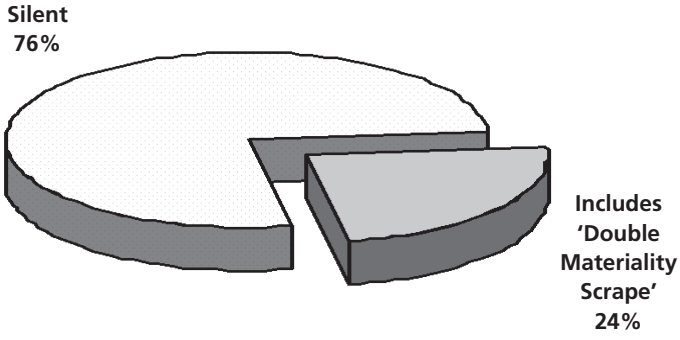
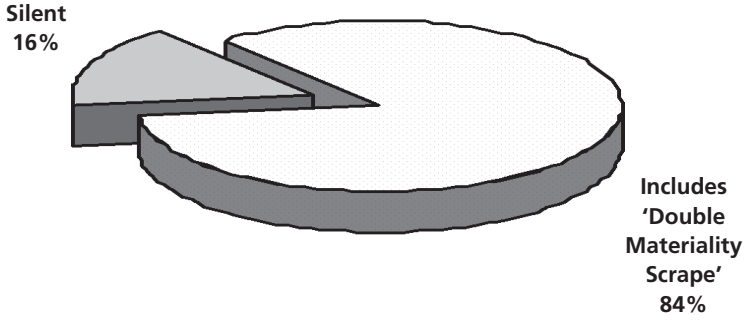


Figure 5: US Study: accuracy of reps: 'bring-down'



US deal lawyers are good at dealing with this by 'scraping' away one layer of materiality. This is achieved by providing in the condition to closing that materiality qualifications in the condition are made on the basis that any materiality qualifiers in the representations are disregarded. US deal lawyers did this in 84 per cent of the deals surveyed for the US Study that have a delayed closing with a 'bring-down' condition with a materiality/MAE qualifier.

The situation is quite different in Canada; of the surveyed deals with a delayed closing that included a 'bring-down' requirement to closing, in only 24 per cent was double materiality carved out from the closing condition. (The European Study did not report on this issue.)

Transaction opinions not as prevalent

Legal opinions related to the transaction (rather than to taxes, which are not measured by the studies) are being explicitly required by the purchase agreement less frequently in North America than in the past. The US Study reported that transaction opinions were required in 58 per cent of acquisition agreements surveyed. This is down from 70 per cent of surveyed acquisition agreements for transactions that closed in 2005, as reported in the 2006 US private target study. The practice is similar in Canada where, according to the Canadian Study, transaction opinions were required in 56 per cent of deals (down from 72 per cent, according to the 2008 Canadian private target deal points study).

In Europe, non-tax legal opinions are rare: the European Study reported that such opinions were only required in one per cent of deals surveyed.

Sandbagging practice varies across jurisdictions

A seller may want to stipulate in the acquisition agreement that it will not be liable for losses that the buyer may suffer by reason of an inaccurate representation or warranty, if and to the extent the buyer had knowledge of the inaccuracy before closing. This is often referred to as an 'anti-sandbagging' provision. Determined buyers might instead insist on a 'pro-sandbagging' or 'benefit of the bargain' clause in the agreement. The typical formation of a pro-sandbagging clause explicitly provides that the rights of the buyer to indemnification for losses based on inaccuracy of any of the seller's representations or warranties will not be affected by any knowledge acquired by the buyer before the closing date.

As seen in Table 3, the practice regarding sandbagging clauses varies across jurisdictions. According to the studies, Europeans much more frequently

include *anti*-sandbagging provisions in their acquisition agreements (in 51 per cent of surveyed deals), to prevent buyers from 'sitting in the weeds' and seeking indemnification for inaccurate disclosures that they knew about before closing. Americans are much more likely to include *pro*-sandbagging clauses (in 39 per cent of surveyed deals), while sandbagging clauses are a less common feature in Canadian deals (either form appeared in 31 per cent of surveyed deals).

Table 3: Sandbagging

	Canadian Study	European Study	US Study
Provisions included	31% of deals	58% of deals	47% of deals
– pro-sandbagging	10%	7%	39%
– anti-sandbagging	21%	51%	8%

Survival periods are longer in Canada

The Canadian Study reported that in 84 per cent of deals, claims for indemnification (eg to recover losses incurred by reason of a representation or warranty being inaccurate) can generally be made within 24 months of closing, with 24 months as the most common general survival period (appearing in 31 per cent of the deals surveyed). Notably, the general survival period was 12 months in 18 per cent of the Canadian deals surveyed and 18 months in only 14 per cent of the Canadian deals surveyed. In 16 per cent of Canadian deals surveyed, claims could be brought during periods longer than 24 months.

This is markedly different from the US Study, which reported the most popular general survival period was 18 months (in 38 per cent of deals surveyed) and in 20 per cent of deals surveyed the general survival period was only 12 months. Twenty-four months was the general survival period in only 17 per cent of deals surveyed and the period was longer than 24 months in a mere six per cent of the deals surveyed.

Figure 6: Canadian Study: survival periods

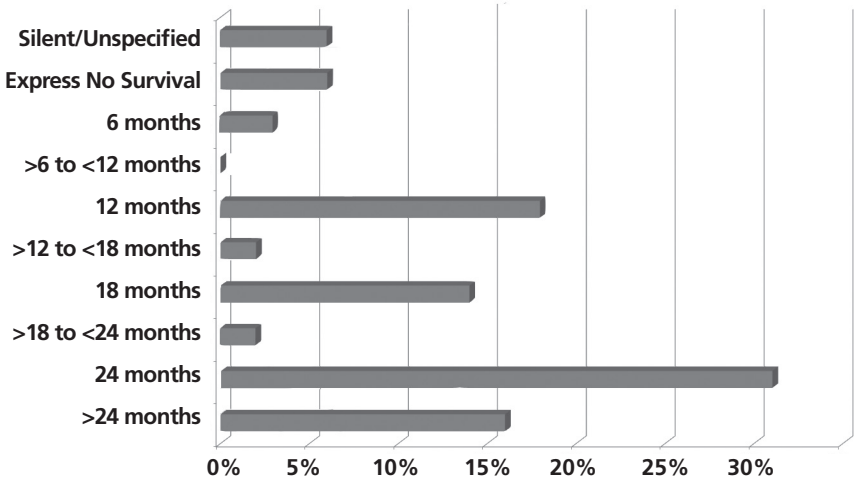


Figure 7: European Study: survival periods

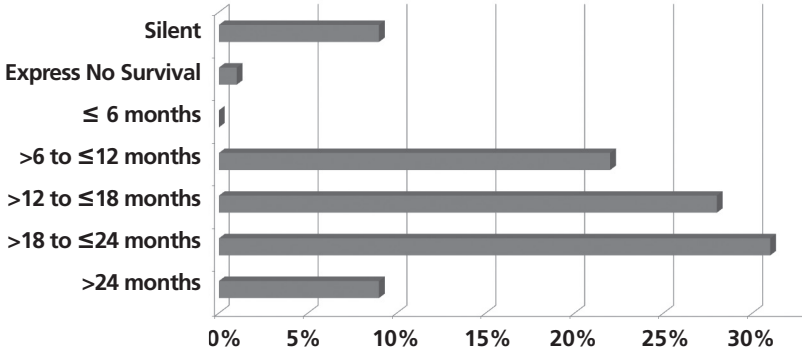
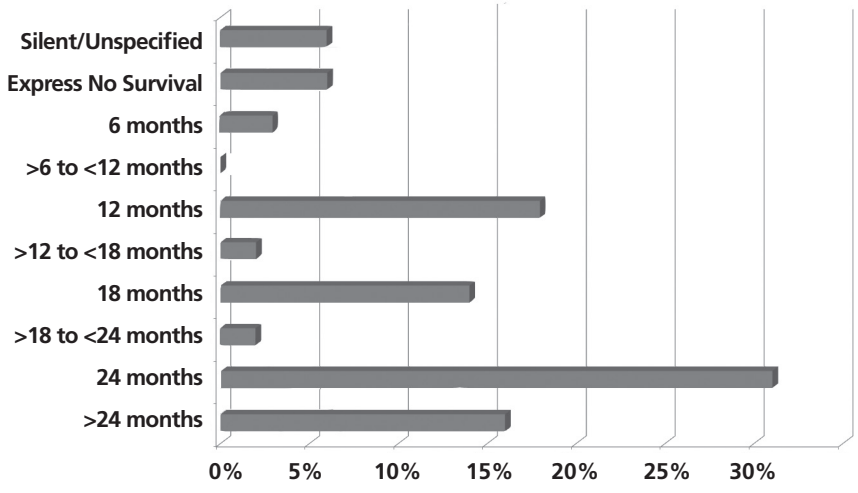


Figure 8: US Study: survival periods



The European trend appears to be somewhat in between. As seen from Figure 7, the European Study reported that the general survival period was between 12 and 24 months in 59 per cent of deals surveyed, with the period of more than 18 months, but less than or equal to 24 months, being slightly more predominant. Few deals surveyed – only nine per cent – had general survival periods that exceeded 24 months, although the same number of surveyed deals – nine per cent – were silent on the point.

Indemnity caps are higher in Canada

There appears to be convergence in European and US practice regarding indemnity caps – that is, the maximum amount a buyer can recover from a seller for indemnification claims under an acquisition agreement. Caps seem to be higher in Canada.

According to the European Study, in 83 per cent of deals surveyed the indemnity cap was less than the purchase price. The cap was equal to the purchase price in ten per cent of surveyed European deals and, interestingly, seven per cent of the surveyed European acquisition agreements included an express no cap or were silent on the point. Similar results were reported in the US Study: of surveyed deals with survival provisions, the indemnity cap was less than the purchase price in 86 per cent of such deals, the cap equalled the purchase price in four per cent of such deals, and eight per cent of such deals did not stipulate a cap.

Figure 9: Canadian Study: indemnity cap

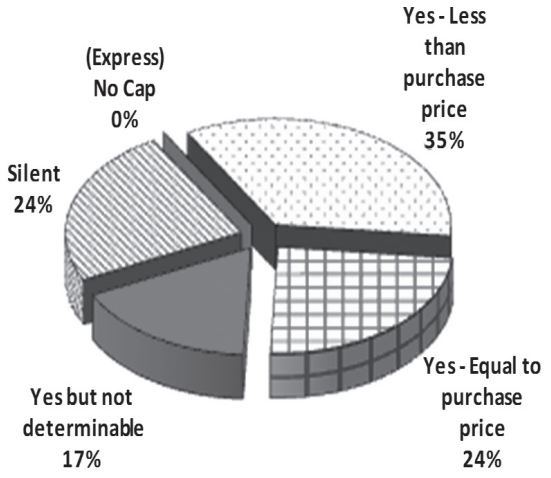


Figure 10: European Study: indemnity cap

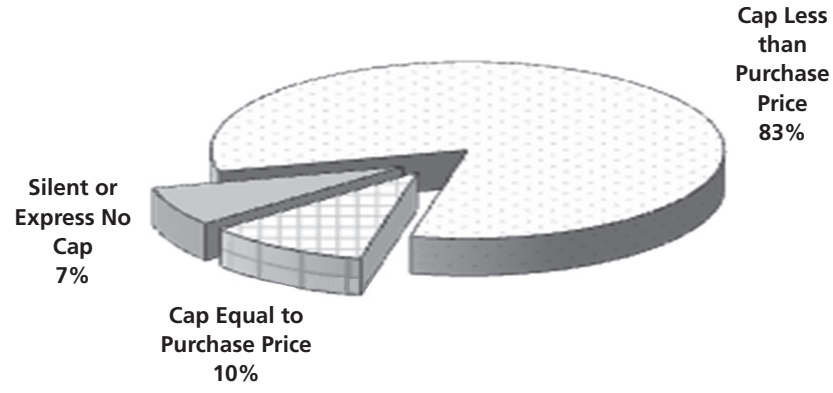
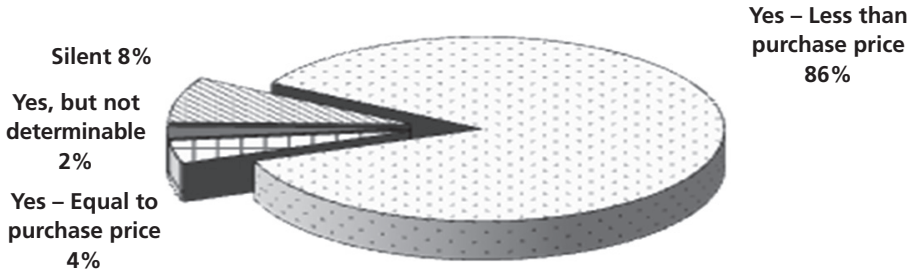


Figure 11: US Study: indemnity cap



The Canadian Study reported that the indemnity cap was equal to the purchase price in 24 per cent of surveyed deals that had express survival provisions. The cap was less than the purchase price in only 35 per cent of those reported deals, but the amount of the cap could not be determined in a large number of those deals surveyed (17 per cent). Remarkably, in 24 per cent of those Canadian deals surveyed, the acquisition agreement did not stipulate any cap (a notable change from the 2008 Canadian Study that reported 44 per cent of the deals surveyed for that study having no indemnity cap).

Indemnity caps as a % of transaction value are lowest in Europe and the US

The European Study reported that of deals that provided for a cap on indemnity claims, the cap was less than or equal to half of the purchase price in 86 per cent of such deals. This is comparable to the United States, where the cap was less than or equal to half of the purchase price in 91 per cent of the deals surveyed for the US Study that had survival provisions and determinable caps. This differs markedly from the Canadian Study, which

reported the indemnity cap was less than or equal to half of the purchase price in only 38 per cent of the deals surveyed that had survival provisions and indemnity caps. This trend could reflect the smaller deal sizes reported on in the Canadian Study relative to the European Study and US Study.

Figure 12: Canadian Study: indemnity caps as a % of transaction value

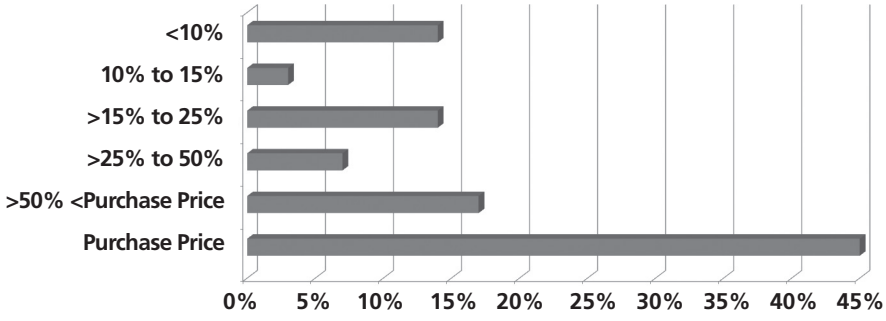


Figure 13: European Study: indemnity caps as a % of transaction value

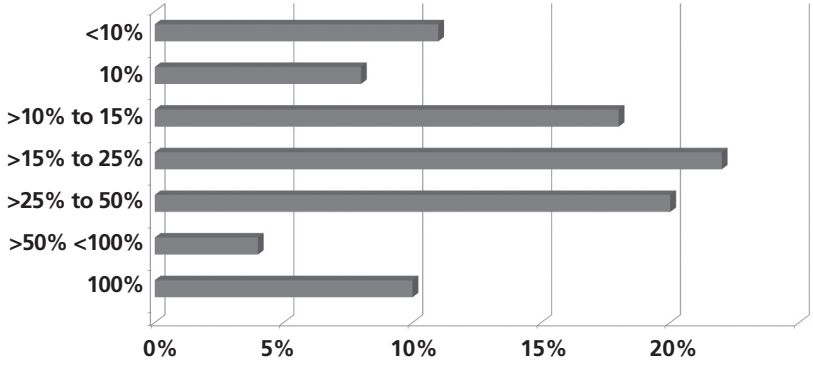
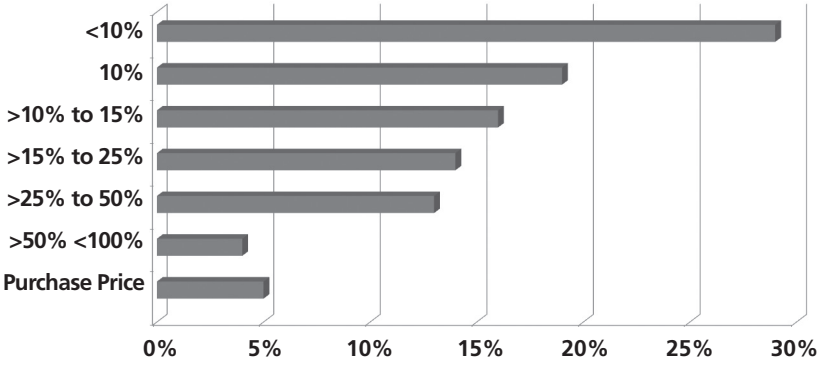


Figure 14: US Study: indemnity caps as a % of transaction value



Europeans prefer to arbitrate their disputes

The studies indicate that North Americans provide for alternative dispute resolution (ADR) less frequently than Europeans: ADR was expressly chosen as an alternative to courts for resolving disputes generally under the acquisition agreement in about one-third of the deals surveyed for both the US Study and Canadian Study and in slightly more than two-thirds of the deals surveyed for the European Study.

Binding arbitration was the most commonly identified ADR in the North American studies (92 per cent of US deals surveyed that included ADR and 100 per cent of Canadian deals surveyed that included ADR). Where ADR was chosen in deals surveyed for the European Study, binding arbitration was the preferred mechanism in all deals (31 per cent under the rules of the International Chamber of Commerce; the balance under national/local arbitration rules).

Observations

The Canadian, European and US Private Target M&A Deal Points Studies are very useful tools for deal lawyers, whether negotiating an acquisition agreement within one of those jurisdictions or involving multiple jurisdictions. The consistent framework and reporting style of the studies make them a convenient checklist for principal points of consideration when drafting an acquisition agreement and the data points in the studies are useful benchmarks against which to measure (and help resolve) sometimes difficult points for negotiation. All of the studies are available from any of the authors, or on the ABA M&A Committee's website at: **http://apps.americanbar.org/dch/committee.cfm?com=CL560003**.