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M&A Perspectives

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Troutman Sanders is pleased to present its latest issue of *M&A Perspectives*, a publication featuring analysis of U.S. mergers & acquisitions market and legal developments.

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M&A Team Spotlight

Tyler Dempsey was featured in Atlanta Business Chronicle's table of experts at their "Middle-Market Mergers and Acquisitions" discussion.

Download a PDF of the article here.

Andrea Farley was named as one of 2019's Top U.S.A. Women Dealmakers by the Global M&A Network.

Download a PDF of the article here.

Leveraging Data Analytics and AI Through the M&A Life Cycle

By: Adam Dennett, Patrick Costello and Christopher Hargett

With ever-increasing troves of underutilized data and information, a result of the pervasive use of technology that permeates our personal and corporate digital lives, the time is now to integrate data analytics and artificial intelligence (AI) into your mergers and acquisitions (M&A) deals.

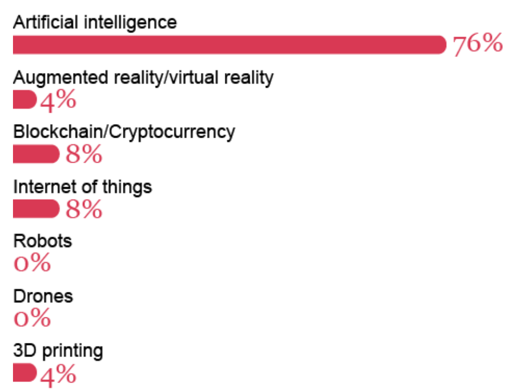
By combining sophisticated algorithms and machine learning, these technologies can efficiently and quickly analyze vast quantities of data, extracting deeper insights that have immense impacts on M&A, divestitures and other transactions. The result: better decision-making, faster. Deal professionals should take note of this potential value and familiarize themselves with this burgeoning technology.

In a recent real-time survey of executive dealmakers from some of the world's top companies, over 76 percent of attendees said AI is the technology most likely to disrupt deal strategy in the near term.[1] And while many companies have yet to take full advantage of such technologies, it is clear that data analytics and AI will play an increasingly important role in deal strategy and execution moving forward.[2] AI's value is not limitless, however, and should not be a substitute for the expertise of legal counsel. But it can make possible more effective use of valuable legal resources. As such, it is becoming a critical tool for dealmakers that enables greater confidence in forecasts and synergy estimates ahead of a deal decision.

Discerning Advantageous from Superfluous Data

Most deals require the review of enormous amounts of data, and the expanding amount of information available has both benefits and drawbacks. According to Deloitte, the amount of data companies produced doubled between 2015 and 2017.[3] It is on track to double again by the end of 2019, and worldwide annual data creation is expected to grow by ten times the amount of data produced in 2017 by 2025.[4] With greater data volumes, an acquirer can now know more about the target than ever before.

What technology is most likely to disrupt deal strategy in the next 12-24 months?



Source: The Deals Exchange

[1] *See Artificial Intelligence and Deals: For Moves That Will Turn AI's Potential into M&A Success*, PwC's Deal Blog (Sept. 4, 2018), at: https://usblogs.pwc.com/deals/artificial-intelligence-and-deals-four-moves-that-will-turn-ais-potential-into-mna-success/.

[2] Id.

[3] *See The Impact of Technology on M&A*, Deloitte Corporate Financier Magazine, August 2016, at: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/corporate-finance/deloitte-uk-impact-of-technology-on-ma.pdf.

[4] *See, e.g., Data Age 2025, The Digitization of the World from Edge to Core*, IDC, David Reinsel, et al. (Nov. 2018), at: https://www.seagate.com/files/www-content/our-story/trends/files/idc-seagate-dataage-whitepaper.pdf.

However, the entire M&A process can also be complicated by the amount of information necessary to review during a deal. According to Gartner, Inc., a global research and advisory firm, more than 80 percent of company data today is unstructured, made up of nonfinancial data such as contracts, social media comments and emails.[5] This makes it difficult to review and extract the value from this information, so it can easily go unused. With AI-powered analytics, however, it is possible to review and analyze this otherwise-underutilized data to improve decision-making. Its utilization can provide unmatched visibility and transparency throughout the entire process.

Using Data Analytics and AI During the Deal Life Cycle

Sourcing

In the beginning of the M&A process, data analytics and AI can help companies predict and identify M&A targets.[6] Today, firms are applying statistical algorithms to analyze companies and target third-party data, speed up deal execution, and inform M&A decision-making. By using an algorithmic or holistic approach to deal sourcing, potential acquirers can distill a large list of active and relevant targets into specific subcategories or segments. This has the potential to result in higher returns on investment, because each segment can be targeted using a different strategy. When this process is implemented, it must be reviewed, evaluated and improved to ultimately become replicable. But this front-end effort can yield long-term gains because the analysis helps dealmakers decide what to purchase and how much to pay by scrutinizing companies' strengths and weaknesses to spot potential investments, taking into account past performance and predictive expectations of the future. And while this technology is unlikely to dissolve the necessary human connections when companies are finding deals, it should at least improve, for example, how private-equity firms leverage their professional networks when sourcing and developing investment ideas.

By using an algorithmic or holistic approach to deal sourcing, potential acquirers can distill a large list of active and relevant targets into specific subcategories or segments.

Moreover, data analytics and AI can be used to extract value from information currently underutilized. For example, they can be used to properly vet and review board members, C-suite executives and employees of targeted companies by sorting, analyzing and summarizing their social media posts in ways that are not otherwise feasible or efficient for traditional deal teams conducting due diligence. Social media platforms such as Facebook, Instagram and Twitter produce a relatively new and abundant source of data that is increasingly essential to the deal as part of proper diligence and vetting. Inadequate review can result in onboarding problems that do not present themselves until it is too late, and that may negatively impact a deal's expected value.

Likewise, the use of data analytics and AI enables comprehensive and comparative use of online company reviews on sites such as LinkedIn, Yelp, Glassdoor, Indeed and Vault that may be useful for sourcing or due diligence. By collecting and sorting qualitatively subjective digital records, such as online posts and reviews, acquirers can better understand a company's reputation with its customers and identify issues with key systems of the target's processes that,

[5] *See Next-Generation Data Strategies*, Gartner, Inc. (Feb. 2, 2018), at: https://www.gartner.com/en/documents/3885882.

[6] *See Why Talent and Technology Should be Driving Your M&A Strategy*, EY, Steve Krouskos (Apr. 15, 2019), at: https://www.ey.com/en_us/ccb/20/talent-technology.

if improved, can deliver added value post-acquisition. Such analysis is made possible by sentiment trackers such as Astute Hootsuite Insights, RapidMiner and Quick Search, which aggregate large volumes of data to concentrate acquirers' attention on important areas such as a target company's competitive market position or whether its online systems work well for customers.

Due Diligence

The due diligence process is particularly suitable for the use of data analytics and AI because it can rapidly review vast amounts of information to uncover potential red flags during reputational and commercial due diligence. In lieu of large teams, data analytics and AI platforms such as eBrevia, Kira and Luminance can search an unlimited number of uploaded contracts to help review large amounts of text and data points to present important issues to legal advisors and due diligence teams. This can streamline human efforts without sacrificing accuracy. And with robust analytics, firms can dive deep into a company's data to gain insights and identify potential problem areas before it is too late.

A ready example is compliance and risk management in which data analytics and AI technology allow targets to be more thoroughly vetted by analyzing information that is traditionally not reviewed, which can minimize the risk of taking on compliance-related liabilities in a merger or acquisition. For example, Neota Logic, a "digital intelligence" business that provides enhanced due diligence and human resources screening, uses cyber intelligence skills, machine learning technology and human analytics to run background checks on management teams by searching the internet, including public records and social media, as well as the deep web and dark web, for any potential risk or compliance issues. This is crucial given the characteristics and range of compliance liabilities both domestically and abroad.

Negotiation and Contracting

In the negotiation and contracting phase, data analytics and AI can likewise provide valuable insights. Because AI systems can extract the wealth of data cached in the lines of negotiated contracts, including dates, timelines, prices and returns, it can relieve the burden on legal resources that would otherwise need to dissect the clauses.

This is particularly valuable when contracts span a wide variety of subjects, as it allows negotiators and deal teams to quickly parse information across diverse business areas. Likewise, data analytics and AI can review publicly filed deal data, such as U.S. Securities and Exchange Commission EDGAR filings, to assemble crucial data point comparisons to give contract negotiators an upper hand, especially when third-party research does not provide such market data or such research is otherwise not readily available.

Data analytics and AI are even aiding contract drafting by saving time and reducing errors with systems such as Contract Express, Neota Logic and High Q. Such data analytics and AI may even be able to identify points of inefficiencies or value loss so that contracts can be improved upon in the future. For example, if a company is acquiring a retailer with numerous brick-and-mortar storefronts, data analytics and AI could be utilized to analyze the voluminous and differing rental contracts and identify average price per square foot, efficiency of space and sales per zip code, providing insights for future deals, recommendations and negotiation goals.

Post-Merger Integration

Post-acquisition, buyers are turning to analytics to help identify potential synergy opportunities, risks and hurdles to prepare for integration and execution.[7] Data-driven solutions allow for the optimization of business activities and identify other potential value-creation opportunities between the merged companies. At Troutman Sanders eMerge, a legal technology and eDiscovery subsidiary of Troutman Sanders LLP, the complex data analytics of Relativity© were recently coupled with experience and industry knowledge to provide innovative "reverse discovery" during the post-integration process. It reviewed in-house contracts and other data to identify competitive information required to be destroyed in order for the company to meet post-closing noncompete requirements and comply with certain laws and industry regulations. Likewise, data analytics and AI can be used to review and then compare acquirer and acquired institutions' contracts to identify which entity has the best outside vendor terms and to leverage such terms enterprise-wide post-merger.

AI-driven automation can also enable the integrated company to rely less on undocumented processes and institutional knowledge that may be lost in the staffing disruptions that can occur after a deal. Data analytics and AI can play a particularly important role for repeatable tasks by consistently executing those tasks following updated policies and procedures. As such, data analytics and AI are useful to better capture expected synergies or other efficiencies post-merger to deliver forecasted value creation.

Conclusion

Moving forward, M&A-focused data analytics and AI use will continue to broaden across industries and the deal process over time, as this use effectively generates and presents opportunities to leverage deal insights. Moreover, the complementary use of data analytics and AI with legal counsel and deal teams can better manage workflows and make the most efficient use of resources. Deal makers should continue to monitor these technologies and should anticipate their quick adoption, as they will continually change the deal process. «

[7] *See, e.g., Not Using Analytics in M&A? You May be Falling Behind*, Deloitte, at: https://www2.deloitte.com/ca/en/pages/finance/articles/analytics-m-and-a-ia.html.

Data Privacy Considerations in M&A Transactions

By: John Bradley and David Rosenfield

Data privacy regulations, high-profile data security breaches, and fines and other regulatory enforcement have significantly affected mergers and acquisitions (M&A) transactions in recent years.[1] Buyers, sellers and M&A practitioners have elevated data privacy to one of the critical issues to address at various stages of an M&A transaction, from due diligence to drafting and negotiating representations, warranties and related indemnities to post-closing integration.

The data privacy legal environment remains one of the most dynamic and fast-developing areas of law, and will continue to affect M&A transactions for the foreseeable future.

M&A participants are well-advised to focus on data privacy early and throughout an M&A transaction given the potential adverse consequences of a security breach, including reputational damage, fines and other regulatory enforcement, loss of business, class action lawsuits, and resulting damages.

Legal Environment

Data privacy is implicated under a number of regulations, some of a more general nature and others specifically tailored to address particular data privacy issues. The Federal Trade Commission, for example, uses its general regulatory and enforcement authority to pursue actions in data security breaches.[2] Specifically tailored data privacy regulations, such as the EU General Data Protection Regulation (GDPR)[3] [4] and the most recently enacted significant data privacy regulation, the California Consumer Privacy Act (CCPA), are directed at data privacy generally, and impose, or will impose, extensive obligations on virtually all businesses within their geographic scope, most particularly in the context of consumer personal information. Industry-specific data privacy regulations such as the Gramm-Leach-Bliley Act (GLBA), which applies to financial institutions, and the Health Insurance Portability and Accountability Act (HIPAA), which applies to the healthcare industry, also impose extensive obligations on businesses that fall within the scope of the industries covered.

The CCPA becomes effective January 1, 2020, and will affect any business of even moderate size that handles the personal or household information of California residents. Businesses that handle this information with respect to

[1] Data privacy security breaches by Yahoo! Inc. demonstrate the importance of data security in the M&A context. Yahoo has proposed to pay $117.5 million to settle claims following large-scale data security breaches that occurred between 2012 and 2016. The settlement is pending and subject to court approval. Yahoo failed to disclose the breaches until 2016, after it had negotiated a $4.83 billion M&A transaction to sell its digital services to Verizon Communications. The deal price was reduced by $350 million as a result of the breaches.

[2] In July 2019, the FTC settled with Facebook, Inc., imposing an unprecedented $5.0 billion penalty over data privacy breaches. The settlement resolves a wide-ranging regulatory investigation into Facebook's massive loss of personal information and mishandling of user communications that allegedly included use of deceptive disclosures and settings.

[3] In early 2019, France's data protection authority, the National Data Protection Commission, acting under the GDPR, fined Google €50 million for failing to properly disclose to users how their data is collected and used, and for lack of valid consent regarding ad personalization. Google uses this data to display personalized advertisements across its services, including its search engine, Google Maps and YouTube.

[4] In July 2019, the U.K. Information Commissioner's Office announced its intention to impose fines of £99.2 million against Marriott International and £183.4 million against British Airways for violations of the GDPR. Marriott International's fine resulted from a security vulnerability discovered in 2018 that exposed the personal information of approximately 339 million guests of Starwood hotels. Marriott International acquired Starwood in 2016. British Airways' fine resulted from a cybersecurity incident in 2018 in which user traffic on the company's website was rerouted to a fraudulent website, allowing the theft of personal data and payment card information of approximately 500,000 customers.

as few as 50,000 devices, individuals or households annually will be subject to the CCPA. Businesses with revenues of at least $25 million will also have CCPA compliance obligations, regardless of the number of devices, individuals or households with respect to which information is handled. In addition, businesses that derive more than half their revenue from selling the personal information of California residents will be subject to the CCPA.

The CCPA includes, for the benefit of California residents, virtually all of the basic rights afforded EU residents under the GDPR, such as the right to be informed of the nature of the personal information a business collects, obtains, sells or discloses about them; the reasons for these activities; and the nature of the third parties to whom the information is divulged. Other rights include the ability of California residents to prohibit the sale of their personal information, and the so-called right to be forgotten, which entails an individual's right to require deletion of the individual's personal information.

Governmental enforcement of the CCPA may result in civil penalties of $2,500 for each violation and up to $7,500 for each intentional violation. In addition, the CCPA includes a private right of action and statutory damages that are likely to incent consumer class action litigation.

The overall trend in the data privacy legal environment is decidedly toward greater and more complex compliance obligations, higher compliance costs, more frequent enforcement, and greater consequences for noncompliance. All of these factors result in higher risks associated with M&A transactions involving the acquisition and integration of businesses that handle personal information.

Commercial Environment

In addition to complying with applicable data privacy regulations, businesses must comply with the terms of their commercial contracts pertaining to data privacy, which dictate how data that flows between contracting parties may be used, handled and stored. Parties to commercial contracts continue to react to the data privacy regulatory landscape by including in their contracts extensive data privacy considerations. These commercial terms increasingly extend beyond customary nondisclosure obligations, and often include a litany of data privacy-related obligations, such as requiring specific data security processes, reporting and audit obligations, data security breach procedures and notification requirements, and special indemnities.

Due Diligence

Buyers, sellers and M&A practitioners should approach data privacy diligence as they approach similar critical M&A issues. This approach should include identifying the seller's key risks that flow from its industry, its geography, the types of data collected or obtained, and how that data is used, handled and stored. M&A participants also should ensure that the seller has the right to make available to the buyer and its representatives information of a sensitive nature, the disclosure of which may trigger violations of data privacy regulations or a breach of contract. Importantly, both the buyer and seller should endeavor to avoid or carefully restrict the transfer of personal information at the diligence stage, including through redaction or otherwise limiting names and other personally identifiable information.

The nature of personal information in the seller's possession, which will directly or indirectly transfer to the buyer at closing, may also affect the transaction structure. For example, some M&A transactions, if structured as an asset purchase as compared to a stock purchase or certain mergers, may present additional risks and challenges if personal information will be conveyed to the buyer as part of the seller's assets transferred at closing. These factors may determine or influence whether an M&A transaction is structured as a stock sale, an asset sale or a merger.

Due diligence should include examination of the seller's privacy policies, data security

programs and processes, both qualitatively and from an information technology (IT) perspective, to ensure that appropriate processes and sufficiently robust IT assets are in place to protect data. A buyer should also evaluate the seller's breach history and response times. Buyers should engage a dedicated team of data privacy and IT experts to assist with this diligence.

Overall, the buyer's due diligence review should enable the buyer to assess data privacy risks associated with the seller's business and identify any outstanding or potential liabilities that may impact valuation or require a special indemnity.

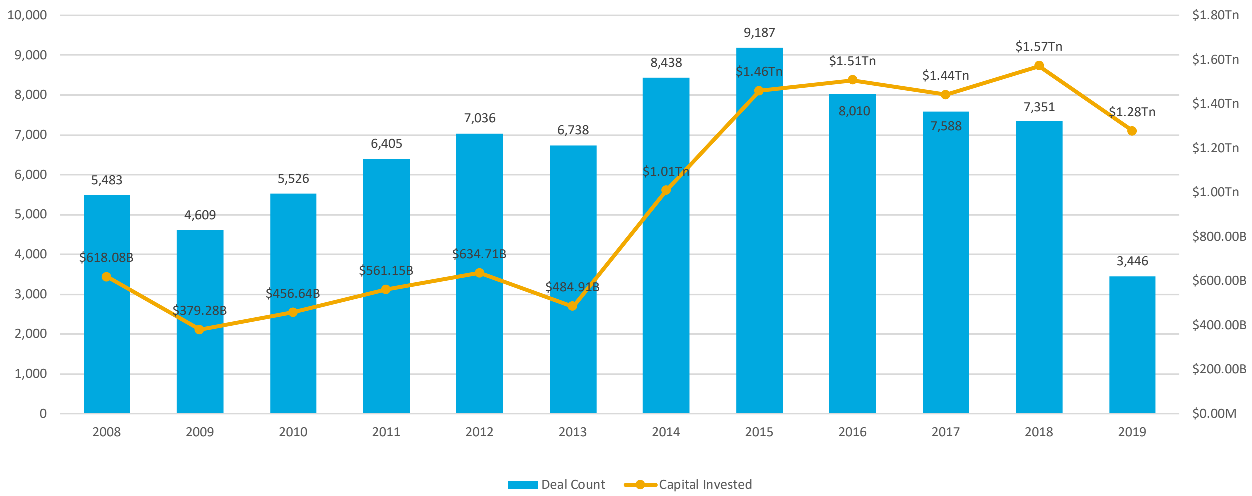
Representations and Warranties, and Indemnities

Most M&A transactions of significant size, and virtually all M&A transactions where data privacy is of particular concern, now employ carefully drafted data privacy representations and warranties. These representations and warranties extend well beyond the generic no-violations-of-law scope and typically will focus on specific regulations, including industry-specific regulations, security breach history and commercial contract compliance, and they may also extend further back historically than a more generic no-violations-of-law representation and warranty.

In addition to legal and commercial compliance, savvy buyers will use data privacy representations and warranties as a risk allocation tool to fix liability for failures of IT system design, poor information handling processes and even certain post-signing data privacy security breaches. In our view, well-drafted, comprehensive data privacy representations and warranties address at least the following areas, where applicable:

- General legal compliance (e.g., GDPR and, after January 1, 2020, CCPA compliance);
- Industry-specific data privacy regulatory compliance (e.g., GLBA or HIPAA compliance);
- Disclosure of arrangements under which data is shared with third parties;
- Data privacy security breach history;
- Regulatory notices, and both external and internal data privacy investigations;
- Suitability of data privacy processes and related IT infrastructure;
- Employee data privacy training;
- Description of the types of personal information collected and maintained; and
- Security assessment reports and related remediation of data security gaps.

U.S. M&A Market Snapshot: Deal Count & Capital Invested



Source: PitchBook

In private-target transactions, buyers may seek special line-item indemnities and longer survival periods for data privacy security breaches, whether known or unknown at the time of signing or closing. Data privacy issues in many M&A transactions are best handled on a customized basis depending on a variety of factors, including those discussed above. To date, we have not seen clear M&A market trends in indemnification terms such as survival periods, line-item indemnities or basket/cap carve-outs as they relate to data privacy issues.

Post-Closing Integration

Post-closing integration may involve the mass transfer of data from the seller to the buyer, implicating numerous data privacy considerations. Even if personal information is not formally transferred, as in an asset sale, a buyer will have access to and may seek to obtain, handle and use the personal information held by the target company post-closing. A buyer should be mindful of the need to maintain strict controls on its access to, and handling and use of, personal information held by the target company. A post-closing integration plan developed concurrently with the due diligence phase of the M&A transaction is essential in situations in which data privacy is of particular concern. A buyer should charge its team of data privacy and IT experts engaged in the diligence process to work with the buyer's integration team to ensure regulatory compliance, appropriate regulatory and consumer notices, and other proper steps are taken to limit post-closing integration risks.

Conclusion

The data privacy legal environment is developing rapidly, and the attendant risks and potential adverse consequences will impact M&A transactions for years to come. Data privacy should be among the critical M&A issues addressed early in and throughout an M&A transaction's life cycle, from structuring the deal to due diligence and documentation, and to post-closing integration. Buyers should engage a dedicated team of data privacy and IT experts to assist from the commencement of an acquisition transaction, and should keep them involved throughout the transaction and through post-closing integration. «

Environmental Due Diligence: An Essential Step in M&A Transactions

By: Andrew Perel and Buck Dixon

The risk of shortcutting environmental due diligence cannot be overstated. There is a tendency during mergers and acquisitions (M&A) transactions to view such due diligence as simply another box to check before closing. It is not. What might appear to be a time-consuming, costly and burdensome process, will not be fully appreciated until businesses are faced with the consequences of not doing so.

This overview highlights several important benefits of proper environmental due diligence, discusses risk allocation and mitigation strategies, and identifies emerging issues.

Protect Your Investment

Regardless of which side of the deal you are on, environmental due diligence is essential to identifying environmental risks and mitigating adverse exposure. For buyers, due diligence helps minimize and/or avoid post-closing surprises and identifies existing conditions that may be used to negotiate purchase price or other deal provisions. For sellers, environmental due diligence allows quantification of current environmental risks to limit future liability. It also allows them to conduct additional remediation to preserve an agreed-upon purchase price, to refine deal terms and to appropriately assign mitigation responsibility. Further, conducting proper environmental due diligence affords sellers the opportunity to market their property as eligible for certain voluntary remediation programs, such as Brownfield Cleanup Programs that encourage private-sector site cleanups to promote their redevelopment.

In addition, proper environmental due diligence that satisfies U.S. Environmental Protection Agency (EPA) All Appropriate Inquiries (AAI) allows parties to qualify for certain liability protections, including the bona fide prospective purchaser (BFPP) liability protection.[1] A buyer who qualifies as a BFPP may not be liable for releases or threatened releases solely by becoming a property's owner or operator.[2]

Satisfying AAI requires an inquiry by an environmental professional (EP).[3] As part of its inquiry, the EP must—among other things—interview past and current owners, review historical information and government records, and physically inspect the property.[4] The EP must also consider information provided by individuals with specialized knowledge of the property, and information related to purchase price, fair market value and environmental liens.[5] Timing is critical because AAI actions must generally be performed within one year before the acquisition date, but some components—including owner interviews, lien searches, government records searches, visual inspections and EP declarations—must be conducted or updated within 180 days of the intended transaction date.[6]

1 40 C.F.R. § 312.20(e).
2 42 U.S.C. § 9607(r)(1).
3 40 C.F.R. § 312.20(a)(1).
4 *Id.* § 312.21(b).
5 *Id.* § 312.22.
6 *Id.* § 312.20(b).

Once its review is complete, the EP documents his or her findings in a Phase I Environmental Site Assessment (Phase I), a foundation of environmental due diligence.[7] The current EPA-endorsed industry standard practice for Phase I is ASTM International Standard E1527-13.[8] If a Phase I identifies certain conditions, further environmental due diligence, including but not limited to a Phase II Environmental Site Assessment (Phase II), may be warranted. Phase IIs involve invasive soil and soil vapor and/or groundwater sampling to further assess whether a property has been environmentally impacted. Unlike a Phase I, a Phase II may not be required before the acquisition date. However, there are benefits to conducting a Phase II before closing. For example, a buyer may use Phase II results indicating a property has been impacted to negotiate a lower purchase price.

Allocating Environmental Risks

Once parties conduct proper environmental due diligence, they can use the findings to properly allocate environmental risks. Parties may allocate risk through familiar contractual tools, such as covenants, indemnities, hold-harmless provisions, and representations and warranties. Parties may also consider other approaches, such as incorporating post-closing remediation obligations into an agreement or requiring buyers to maintain due diligence as confidential. Ultimately, it is important to choose an approach that fits the particular transaction and equitably allocates responsibility.

Mitigation Strategies

There are a number of tools parties may use to ensure environmental impacts are remediated and that the costs of conducting the remediation are mitigated, including:

Environmental Escrow Account: At closing, a party places funds into an escrow account to be used to mitigate environmental cleanup and remediation costs. Opinions of Probable Cost, which EPs prepare to estimate the reasonable worst-case scenario for environmental issues, are used as the technical base in setting escrow amounts.

Environmental Impairment Liability (EIL) Insurance Policy: Provides coverage for costs associated with cleanup and remediation of environmental impacts for an off-site pollutant, protection against third-party liability and protection for non-owned disposal site, among other coverage parts. It is important to note that coverage may be available for pre-existing conditions. Types of coverage include EIL coverage, cost cap coverage and finite risk coverage. These policies should be tailored to fit the specific site and conditions at issue.

7 *Id.* § 312.21(c).
8 *Id.* § 312.11(b).

In addition to these tools, state or federal regulators may require certain types of operations to demonstrate that they have the financial resources necessary to properly close a facility when the facility's operational life is complete. For example, the Resource Conservation and Recovery Act requires owners of hazardous waste treatment, storage and disposal facilities to demonstrate financial assurance.[9]

States may also have funds that pay for remediation costs associated with environmental impacts resulting from specific activities. For example, many states have underground storage tank (UST) trust funds that provide reimbursement for costs associated with remediation of soil and groundwater impacts resulting from UST releases. These programs typically require operators to pay into such funds in order to be eligible for receiving reimbursement. As with allocating risk, it is important to tailor a strategy specifically for the particular transaction.

Emerging Issues

Indoor air quality, particularly vapor encroachment, is an area of due diligence that has garnered significant attention. For the first time, the 2013 revisions to the ASTM E1527 guidelines expressly contemplated vapor. Specifically, the "migrate/migration" definition was amended to include vapor migration.[10] While vapor migration was often considered in the course of environmental due diligence prior to this change, such consideration was not a requirement until the 2013 revisions. This change reflects the importance of ensuring vapor migration concerns are adequately contemplated.

To this end, radon has recently attracted greater attention. Radon is a gas that can upwardly move through foundational cracks and holes into living spaces. According to EPA, radon gas is the leading cause of lung cancer among nonsmokers.[11] Radon gas is particularly a concern for residential properties, and while technically it is a non-scope item under ASTM E1527-13, parties will often require that radon gas be assessed, generally through determination of whether the property is located in a low-, moderate- or high-potential radon gas area.[12]

Indoor air quality, particularly vapor encroachment, is an area of due diligence that has garnered significant attention.

While ASTM International Standard E1527-13 is the current standard for environmental due diligence, these guidelines sunset in 2021. However, an update to the guidelines may come before then.

Conclusion

Conducting proper environmental due diligence has tremendous upside. Doing so allows parties to enter a transaction with a fuller picture of the property involved, potentially qualify for liability protections, appropriately allocate risks and adequately remediate environmental impacts. These benefits substantially outweigh the time, costs and burdens the due diligence process may present, not to mention the consequences of not identifying such issues early. «

[9] *Id.* §§ 265.143, .145.

[10] See ASTM Standard Practice E1527-13 at 3.2.56.

[11] https://www.epa.gov/radon/health-risk-radon

[12] The EPA maintains a map of radon zones, designated as Zone 1 (high radon potential), Zone 2 (moderate radon potential) and Zone 3 (low radon potential). See EPA, Map of Radon Zones, https://www.epa.gov/radon/epa-map-radon-zones (June 20, 2019).

Delaware Case Law Update: Refinement of MFW Conditions

By: Brendan Thomas, Tyler Dempsey and Hannah Provost

In 2014, the Delaware Supreme Court (the "Court") decided in *Kahn v. M & F Worldwide Corp* ("MFW") that the business judgment rule, rather than the entire fairness standard, would apply to controlling stockholder squeeze-out transactions if certain conditions are met.

In *MFW*, the Court found that the business judgment rule would apply in the context of a squeeze-out transaction involving a controlling stockholder when "(i) the controller conditions the procession of the transaction upon the approval of both a special committee and a majority of the minority stockholders; (ii) the special committee is independent; (iii) the special committee is empowered to freely select its own advisors and to say no definitively; (iv) the special committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority."[1]

In later cases, this standard was condensed into two key conditions—the transaction must be approved by an "independent, adequately empowered special committee that fulfills its duty of care" and an "uncoerced, informed vote of a majority of minority stockholders."[2] However, as later cases make clear, the final terms of a controlling stockholder transaction containing these conditions are not sufficient. Rather, the controlling stockholder must condition its offer on these protections *ab initio* in order for the business judgment rule to apply.

These requirements represented a large departure from the Court's previous treatment of controlling stockholder transactions; the entire fairness standard, a higher standard than the business judgment rule, previously applied. The Court reasoned that in utilizing these two conditions from the outset, minority stockholders were adequately protected from overreaching controlling stockholders as these conditions would serve to effectively neutralize the controlling stockholder's control.

The Meaning of *Ab Initio*

Following the *MFW* decision, the meaning of *ab initio* was interpreted by courts and M&A practitioners alike to mean "from the outset of the transaction." In two recent cases, *Flood v. Synutra International, Inc.* ("*Synutra*") and *Olenik v. Lodzinski* ("*Lodzinski*"), the Court addressed the meaning of *ab initio* in order to define what constitutes the beginning of a transaction.

In October 2018, the Court's decision in *Synutra* offered further clarification as to how soon a controlling stockholder must condition a transaction on the protections laid out in *MFW* and refined in succeeding cases. In *Synutra*, the plaintiff stockholder argued that *MFW* did not apply and the entire fairness standard should apply to evaluate a controlling

[1] *Kahn v. M & F Worldwide Corp., 88 A.3d 635, 639 (Del. 2014).*

[2] *Id. at 642.*

stockholder buyout because the initial offer letter provided by the controlling stockholder did not contain the required *MFW* conditions.

The Court disagreed, reasoning that such a strict reading of the *ab initio* requirement was at odds with the underlying reasoning for requiring the controlling stockholder to condition its offer early in the transaction. The Court explained that, in deciding *MFW*, it wanted to "ensure controllers could not use the conditions as bargaining chips during economic negotiations."[3] The fact that the business judgment rule could apply when reviewing a controlling stockholder transaction was meant to incent controllers to condition the transaction early in the process on these key protections rather than using them later in the process as a threat to get a better price.

In *Synutra*, the Court found that even though the original offer letter did not include the *MFW* conditions, the second offer letter containing the *MFW* conditions was sent "before any economic negotiations took place."[4] The Court clarified the ordinary meaning of "from the beginning" to be the first stage of an ongoing process. The Court pointed to the fact that the second offer letter (which included the *MFW* conditions) arrived just over two weeks after the first offer letter and "before the special committee ever convened and before any negotiations ever took place."[5]

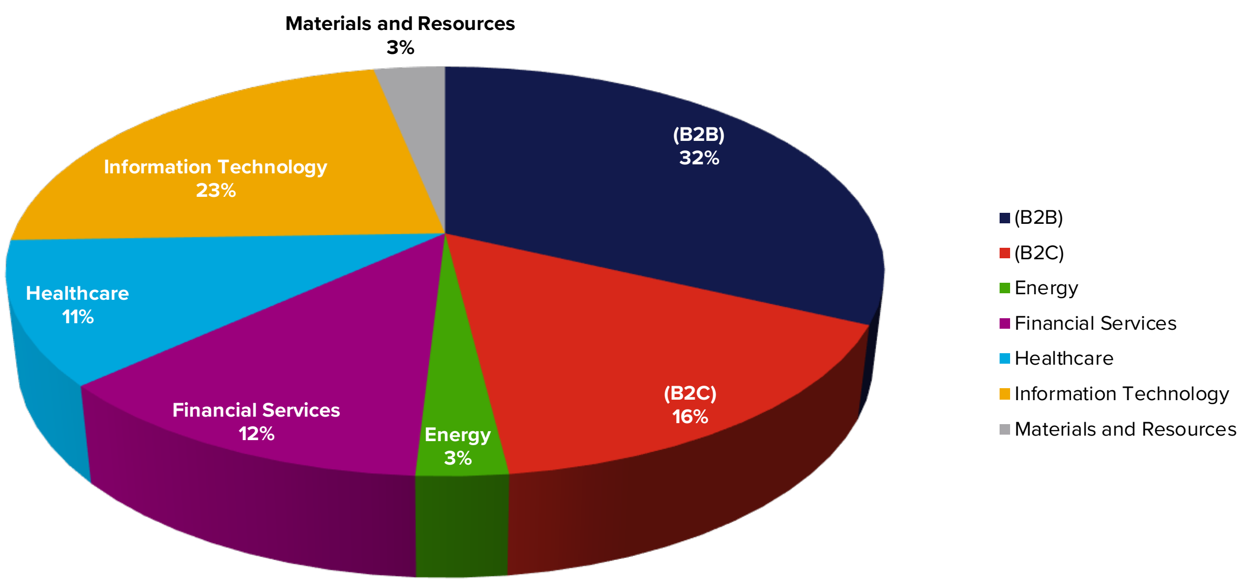
Setting the Boundaries of "Substantive Economic Negotiations"

In April 2019, just six months following the *Synutra* decision, the Court handed down a decision in *Lodzinski* that provided an example of when substantive economic negotiations are too far along to meet the *ab initio* requirement. In *Lodzinski*, two companies with the same controlling stockholder entered into a stock-for-stock

[3] Flood v. Synutra Int'l, Inc., 195 A.3d 754, 762 (Del. 2018).
[4] *Id.* at 764
[5] *Id.*

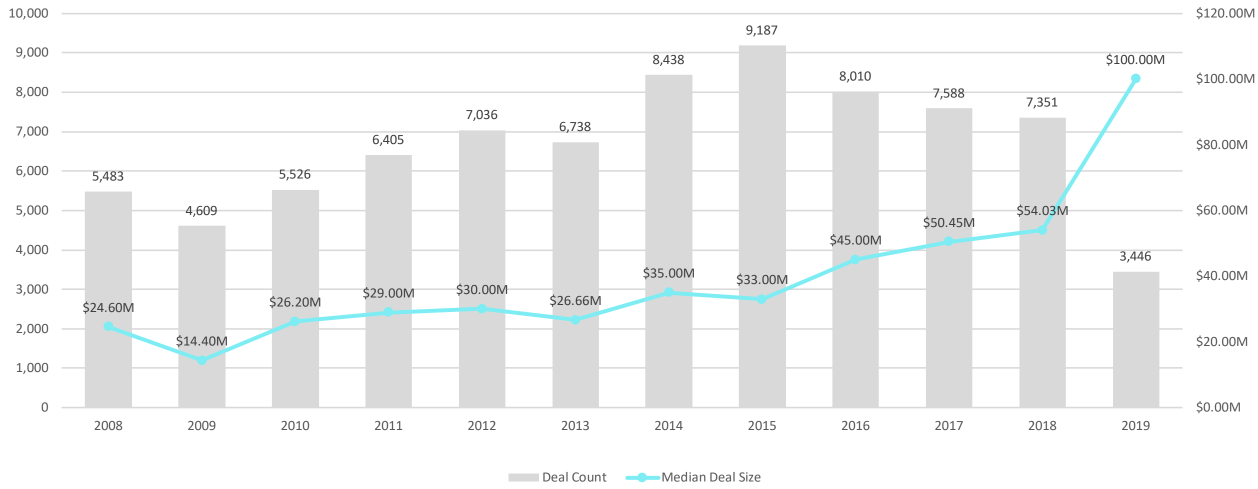
Deal Count by Primary Industry Sector

Deals completed 1/1/2019 - 8/16/2019



Source: PitchBook

U.S. M&A Market Snapshot: Capital Invested & Deal Count



Source: PitchBook

merger. A minority stockholder asserted that *MFW* did not apply in its suit for breach of fiduciary duties because the controlling stockholder did not condition the merger upon the *MFW* protections until 10 months into the negotiations.

As compared with the two-week lag in *Synutra* in which little to no progress was made in the negotiations, in *Lodzinski*, the Court noted that extensive negotiations occurred during the 10-month period before the *MFW* protections were in place. As a result of these extensive negotiations, the Court held that "the well-pled facts in the complaint support a pleading stage inference that preliminary discussions transitioned to substantive economic negotiations" and therefore "the complaint should not have been dismissed on *MFW* grounds."[6]

Prior to conditioning the merger upon the *MFW* protections, many substantive economic negotiations occurred, leading the Court to believe that these conditions were not made *ab initio*. First, the parties engaged in "substantive economic negotiations…in a joint exercise to value" the two companies.[7] Additionally, at a board meeting prior to putting the *MFW* protections in place, "management presented a transaction with an already approved timeline…and an 'assumed' price."[8] Finally, the two independent directors in the transaction did not begin taking steps to form a special committee until almost eight months after the initial discussions.

Takeaways for Controlling Stockholder Transactions

The *MFW* protections must be put in place prior to the commencement of substantive economic negotiations in order for the Court to apply the business judgment rule in the context of controlling stockholder squeeze-out transactions. This will prevent controlling stockholders from using these protections as a bargaining tool to negotiate a better price in the transaction.

Best practices include conditioning any controlling stockholder transaction from the

6 *Olenik v. Lodzinski, 208 A.3d 704, 717-18 (Del. 2019).*
7 *Id. at 707.*
8 *Id. at 717-18.*

outset on the approval of an independent, adequately empowered special committee that fulfills its duty of care and an uncoerced, informed vote of a majority of the minority stockholders. However, if preliminary talks between the controlling stockholder and the target have already begun, making clear that the *MFW* protections are a condition of the transaction as soon as possible is imperative to protect the transaction from receiving an entire fairness standard of review. Delaware courts seem willing to allow some minor preliminary discussions; however, the longer the discussions proceed and the more detailed they become, the more likely the transaction is to be subject to the entire fairness standard of review. «

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Value Not Disclosed Merger with NeuBase Therapeutics, Inc.	USD 35,000,000 PORTFRESH Sale to Americold Realty Trust	Value Not Disclosed Acquisition of Emerald Landscape, Co.	Value Not Disclosed Merger with Morris Bank