Transatlantic Trends in Private M&A Transactions

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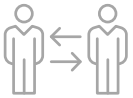
Looking Back on 2018

Deal activity – record values, lower volumes, impact of political uncertainty



Convergence on U.S. vs. European norms

Seller friendly terms – locked box, limited recourse

Political and regulatory intervention

Focus on big data – data privacy regulation and cyber security

Expansive use of rep and warranty insurance

1 Political and Regulatory Intervention in M&A

UK Foreign Investment Screening

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Amendments to the filing thresholds (effective from June 2018), provide the UK Competition and Markets Authority ("CMA") with increased powers to scrutinise transactions in certain sectors:

- Reduced the '*target turnover threshold*' in sensitive sectors from £70 million to £1 million
- Broadened the '*share of supply threshold*' to catch targets with 25% or more share of supply in the UK, even if the acquirer has no presence in the sector

Voluntary filing regime BUT expands the UK government's ability to "*call-in*" transactions deemed to be of interest

UK focus:

- Military and dual-use sector
- Advanced technology sector, e.g. multi-purpose computing hardware, quantum-based technology

<u>and</u> the UK has also suggested further sectors for discussion...

UK Foreign Investment Screening – What's Next?

24 July 2018 – National Security and Investment White Paper:

- Significantly expanded scope
  - Acquisitions of >25% shares or vote, acquisitions of "significant influence or control" over entities/assets
  - Sectors include civil nuclear, communications, advanced technologies, software, high-tech, energy
- Statement of policy intent – 3 risk factors (to be approved by Parliament)
- Decision-making powers with Senior Cabinet Minister not CMA (with "call-in" power)

- Process
  - Voluntary notification (15 working days, potentially extended by a further 15 working days, to decide whether to assess) or "call-in" if no notification
  - 30 working days to conduct review, extendable by a further 45 working days
  - Information requests – formal review can be suspended if requests are not addressed in sufficient detail
  - CMA mandatory information sharing

- Fines (up to 10% of global revenues) and potential criminal sanctions for non-compliance
- Consultation period ended in October 2018 – draft legislation to be presented to Parliament
- UK anticipating **200** notifications a year, **100** notifications to require full assessment, and **50** notifications to require remedy → compared with **60-65** CMA cases per year (62 in 2017/18) and anticipated **60-70% case load increase** post-Brexit

EU Proposals – Core Objectives

Current position: 12 of the 28 EU Member States have national investment review mechanisms but there is currently no centralised EU-level screening

European Commission ("EC") proposals published on 13 September 2017 set out three core objectives:

1

Enshrine **minimum standards** for national review mechanisms (e.g., transparency, non-discrimination between investments of different origin, an obligation to offer judicial review of decisions); *critical technologies or critical inputs*", e.g. Horizon 2020, Galileo, TEN_T, TEN-E and telecommunications)

2

Intensify cooperation and information sharing between Member States and the EU-level institutions; and, TEN-E and telecommunications)

3

Provide a mechanism for the **EC to review and opine on proposed investments of "*Union interest*"** (i.e., programmes which enjoy substantial EU funding and/or are covered by EU legislation on "*critical infrastructure, critical technologies or critical inputs*", e.g. Horizon 2020, Galileo, TEN_T, TEN-E and telecommunications)

In instances where the EC opines on transactions of "*Union interest*", the affected Member State(s) will be under an obligation to take "*utmost account of the Commission's opinion*"

EU Proposals – What's Next?

Next steps:

- Trilogue provisional agreement – 20 November
- Council vote on 5 December; final approval expected by March 2019

- Particular concerns about Chinese SOE investments in high-tech and critical infrastructures
- Chinese delegation raised concerns regarding potential for discriminatory decisions being taken against prospective investment by Chinese companies

EU Proposals – What's Next?

AND parallel reforms in major EU Member States

Germany:

- Introduced a stricter regime in July 2017; 80-100 notifications per year
- Further reforms being debated: >10% acquisitions to be caught
- *Yantai Taihai/Leifeld* (July 2018): first prohibition

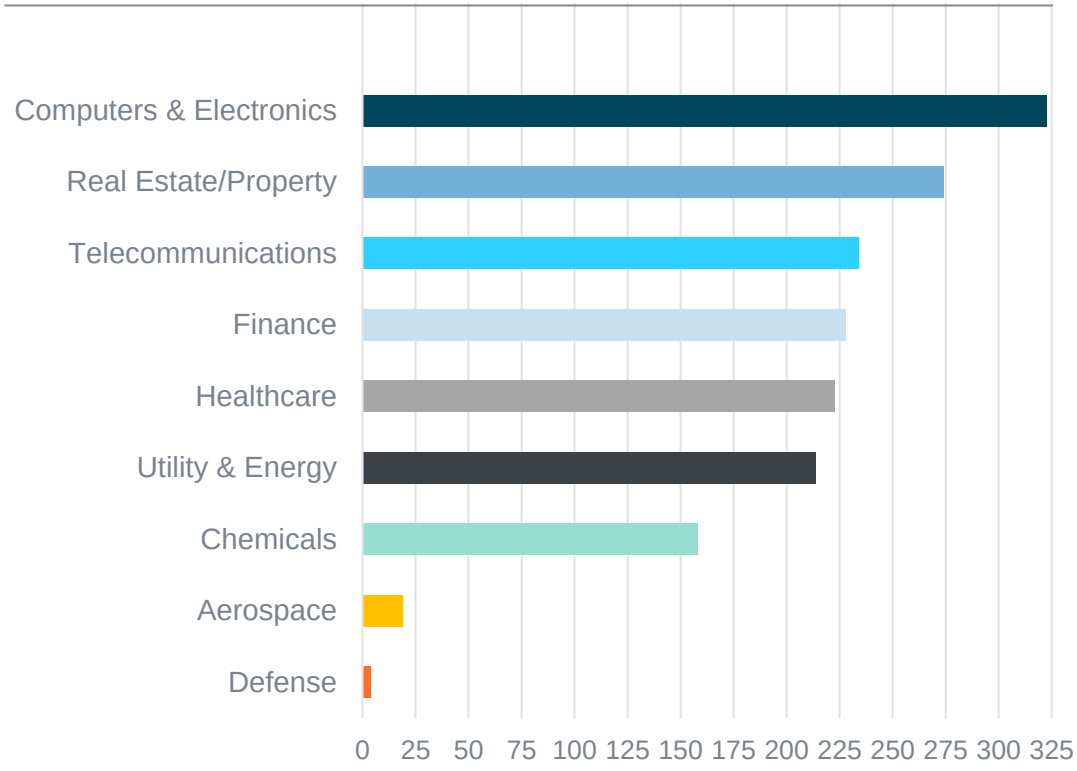
France:

- Announced plans to update screening rules

UK:

- Obligation to consult with EC during Brexit transition period
- UK investment into Europe to be caught by EU regime post-Brexit

Value of deals (EUR bn) since end of financial crisis



Value of deals in EUR bn (Q2 2017)
Source: Dealogic M&A Analytics

Foreign Investment Screening in other G20 jurisdictions

China State Administration for Market Regulation (SAMR)

- Merger review law expressly requires the consideration of national strategic interests during the antitrust review: recent reforms may allow for greater political direction of merger reviews
- 57 industries in which a national security review may be triggered, including military, national defense-related products/services, agricultural products, energy, information technology, telecommunications and heavy equipment manufacturing

CFIUS: increased caseload, ongoing reforms, Trump administration openly sceptical of Chinese investment into the US

Established review mechanisms in other G20 including Australia, Canada, Japan, Russia

Global trend towards greater protectionism with major jurisdictions extending their – often discretionary – investment screening powers

- Increasing number of sectors at high risk of close scrutiny (e.g., critical infrastructure, dual-use sector, robotics, semiconductors etc.)
- Deal Timetabling: importance of early assessment of FDI and antitrust filing risk
- Remedy Design:
  - Ability of complainants to disrupt transactions
  - Remedies will need to address both antitrust and national security concerns: does the potential remedy package impact the business case?

2 Impact of Data Privacy Regulation and Focus on Cybersecurity

What is the GDPR?

Effective **May 25, 2018**

Extraterritoriality

The GDPR governs the processing of E.U. personal data by companies both within and outside of the E.U.

- **Processing** is defined broadly as any kind of use, including storage and destruction
- **Personal Data** includes online identifiers and location data
- **Processing outside the E.U.** related to offering goods or services or monitoring behavior in the E.U. is covered

Scope

The GDPR governs the processing of personal data by data *controllers* (determining the purpose and means of the processing) and data *processors* (processing on behalf of the controller)

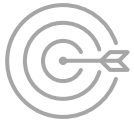
Fines

GDPR violations can result in fines up to the greater of **EUR 20 million or 4% of total worldwide annual turnover** of the preceding financial year

How Data Privacy and Cybersecurity Obligations Affect M&A Transactions

Target Valuation

- Potential civil and regulatory liability from undisclosed cyber breach or data privacy violation
- Business model dependent on practices that violate privacy regulations
- Nature of data results in costly regulatory compliance obligations



Target Characteristics

- Importance of the data (personal or otherwise) to the target's business
- Type of data (PCI, SSNs, highly sensitive information)
- Consumer focused vs. business to business
- Geographic footprint (extent of operations in the E.U. / transfers abroad)
- Heavily regulated component of target business (healthcare, financial services, etc.)

Relevance for Cross-Border Transactions

- Personal data may be transferred outside of E.U. as part of transaction
- Such transfers require implementation of specific protections
- Consider extent necessary to share personal data as part of M&A process

Deal Considerations: Transaction Agreements, Risk Allocation and Closing and Post-Closing Implications

Reps and Warranties

- "Personal Data" must be broad enough to cover the GDPR's expanded breadth
- Compliance with more than Law
- Appropriate information security program
- No breach, exfiltration or unauthorized use of personal data
- No breach notification obligations or notifications made
- No claims, investigations or complaints
- No restriction on transfer

Risk Allocation

- Consider adequacy of representation and warranty indemnity survival periods and limitations on liability
- Consider special indemnities for any known issues
- Consider whether personal data and cybersecurity issues can be excluded liabilities
- If utilizing representation and warranty insurance, check if data privacy is excluded

Closing / Post-Closing

- Transfer of target data as part of Closing must be lawful
- Transfer of target data outside of the E.U. requires appropriate basis
- Transition Services Agreements involving personal data must meet controller-processor or controller-controller requirements
- Buyer's planned use of data may not be permitted without updated, affirmative consents from or notifications to relevant data subjects
- New or expanded regulatory compliance function

3 Ever-Growing Use of Rep and Warranty Insurance

Two Types of Rep and Warranty Insurance Policy

	Buy-side policy	Sell-side policy
Rationale	▪ Seller unable or unwilling to provide recourse acceptable to buyer ▪ Buyer concerned about credit worthiness of seller ▪ Management providing the warranties	▪ Seller wants to back to back risk of a claim
Features	▪ Buyer policy covers loss arising from a matter which would be a breach of warranty ▪ Buyer may claim directly against insurer without pursuing Seller ▪ Cover for Seller fraud	▪ If buyer makes a claim, seller will turn to the policy for cover ▪ Seller remains liable to buyer, but insurer will become involved in claims process ▪ No cover for Seller fraud
Potential Issues	▪ Consistency between SPA and policy ▪ Disclosure ▪ Buyer retains loss after SPA remedies and insurance cover are exhausted	▪ Consistency between SPA and policy ▪ Insurer requires excess under policy (kicks in after de minimis and basket under SPA) ▪ Control of claims process

Differences in U.K. vs. U.S. Approach

- Pricing
- Disclosure
- Policy period
- Basis of loss for warranties
- Deductible, de minimis and policy limit
- Materiality scrape
- Knowledge scrape
- Scope of exclusions

Current Market Trends

- Transaction insurance very common in Europe, particularly in the UK
- Buy-side policies, but process initiated by sell-side

- Recent trends?
  - Pricing terms and speed of cover still improving
  - Insurers increasingly willing to reduce list of exclusions
  - Synthetic policies
  - Use of U.S.-style reps and warranty insurance in Europe
- Developing history of claims

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